Faces of Fraud

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Course Information

Course Title: Faces of Fraud

Learning Objectives:

- Identify a common denominator in all boiler room scams
- Recognize an area in which fraudulent activity can be prevented
- Spot the term which refers to a fraudster’s self-confidence for managing the stress that occurs when committing fraud
- Determine what is accomplished through the Addition by Subtraction Theory
- Discern who is often most effective in assisting in a fraud investigation
- Identify what is crucial to an investigator’s ability to recognize red flags and embrace best practices in preventing fraud
- Recognize the meaning of grafter
- Pinpoint the true motivation behind fraudsters’ actions
- Identify the weapon of choice in stopping widespread fraud
- Recognize an innovative concept for revealing a widespread fraud scheme that provided kickbacks to corporate purchasing agents for buying inflated cleaning supplies
- Spot a valuable asset in gathering information about fraudulent activity
- Identify a valuable investigative tool that can assist an investigator in finding evidence
- Ascertain what is essential in gathering information from fraudsters
- Determine one way an investigator can make his own luck
- Discern what can significantly improve investigative results
- Recognize an internal control that can assist in preventing property insurance fraud
- Determine what is absolutely critical in fostering a climate of honesty and integrity in every organization
- Ascertain what is first and foremost in any investigation
- Identify what often leads to arrests and recidivism
- Recognize a strategy which is effective in minimizing losses due to credit card fraud
- Pinpoint a warning sign of mail-in offer rebate fraud
- Ascertain the most important information an investigator can gather before working with a confidential informant
- Identify one reason why people become informants
- Discern what classifies an informant as undesirable
- Recognize the term used for more experienced salespeople who step in to close the sale
- Identify the sales pitch a reloader would use to contact a new hire taking over the position of his former contact
- Spot a red flag of boiler room vendor kickback schemes
- Recognize the definition of credit card factoring
- Identify the meaning of circularization
- Pinpoint a warning sign of telemarketing fraud
- Recognize a technique used by fraud telemarketers when victims question the validity of the offer
- Determine what air-bagging is
- Identify a warning sign of charity fraud
- Spot a control measure for detecting charity fraud
- Identify the comprehensive learning approach for gaining experience in fighting fraud which combines on-the-job experience, learning from a mentor, and formal training
• Discern what is critical in fraud investigations because it enables investigators to leverage investigative talent and resources
• Determine what most often discourages fraudsters from committing fraud
• Recognize an activity that improves compliance with an organization’s Code of Conduct

Prerequisites: None

Program Level: Overview

Program Content: Reveals must-know characteristics of fraudsters and the skills needed to outwit them. Recognized fraud fighting expert Martin Biegelman draws from his 40 years of experience fighting fraud to profile not only the key traits fraudsters share, but also the qualities fraud examiners must possess to be successful. Each chapter contains stories from actual cases that the author investigated. Profiles the must-know characteristics of fraudsters and the skills you'll need to outwit them; reveals the traits of accomplished fraud examiners; and explores the best practices in fraud detection, investigation and prevention to cultivate in order to maximize success. Although fraud will never be completely eradicated, there is much that can be done to reduce the number and size of frauds that take place in any organization. Boiling down the key lessons the author has culled from his long career, Faces of Fraud entertains and informs with stories from real cases the author investigated over his long career, and imparts useful tips you can start using right away in the fraud examination field.

Course Category: Accounting

Advance Preparation: None

Recommended CPE Credit: 15 hours
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**Martin T. Biegelman** has been fighting fraud and corruption for 40 years in various roles in law enforcement, consulting, and the corporate sector. He is currently a Managing Director in Navigant Consulting’s Global Investigations and Compliance Practice where he conducts internal investigations on behalf of corporate management and boards, Foreign Corrupt Practices Act and antibribery compliance, litigation consulting, due diligence, and corporate compliance design and implementation.

Martin has conducted and managed hundreds of complex and high-risk internal investigations in more than 70 countries. Prior to joining Navigant, Martin founded and led Microsoft Corporation’s Financial Integrity Unit, a highly acclaimed global fraud prevention and anticorruption program. During his more than eight and a half years of leadership as Director of Financial Integrity, he created a reactive and proactive investigative coverage model with offices and staff in Redmond, Singapore, Beijing, Delhi, Moscow, Paris, Prague, Dublin, and Ft. Lauderdale while protecting Microsoft from financial and reputational risk.

Prior to joining Microsoft, Martin was a Director of Litigation and Investigative Services in the Fraud Investigation Practice at BDO Seidman, LLP. He is a former law enforcement professional having served as a U.S. Postal Inspector in a variety of investigative and management assignments. As a federal agent, he was a subject matter expert in fraud detection and prevention. He retired as the Inspector in Charge of the Phoenix, Arizona, Field Office of the Postal Inspection Service. Earlier in his career, he was a criminal investigator with the San Francisco District Attorney’s Office where he investigated economic crime and official corruption.

Martin is widely recognized as a thought leader in fraud and corruption prevention and is both a Certified Fraud Examiner and Certified Compliance and Ethics Professional. He is the Chair of the Board of Advisors for the Economic Crime Institute at Utica College and also serves on the Accounting Advisory Board for the School of Business at the University at Albany, State University of New York. In 2008, he was appointed by Washington State Governor Christine Gregoire to serve on the Washington State Executive Ethics Board with his appointment ending in 2011. In 2009, he took a leave of absence from Microsoft to accept an appointment as Assistant Director and Deputy Chief Investigator with the Financial Crimes Inquiry Commission to investigate the root causes of the financial crisis.

He is a sought-after speaker and instructor on white-collar crime, corruption, the FCPA, identity theft, fraud prevention, and corporate compliance and has written six authoritative books on these topics. He is the 2008 recipient of the Cressey Award, bestowed annually by the Association of Certified Fraud Examiners for lifetime achievements in the detection and deterrence of fraud. In 2010, Martin received an honorary doctorate of laws from Utica College for his leadership role on behalf of students and faculty of the college as well as his lifetime contributions to fraud prevention and anticorruption compliance.

Martin holds a Master’s degree in Public Administration from Golden Gate University and a Bachelor of Science degree from Cornell University.
Preface

I have lived my life fighting fraud and fraudsters. My 40-year career started as a fraud investigator in state and local law enforcement, and later moved to a role as a federal agent tackling more complex fraud and corruption cases. When I retired from law enforcement, I went to work in a forensic consulting practice assisting public and private companies with internal investigations and litigation issues, and designing fraud prevention programs. That was followed by the exceptional opportunity and experience to create and lead Microsoft Corporation’s Financial Integrity Unit. There I built a worldwide team of outstanding fraud and corruption fighters to protect Microsoft from financial and reputation risk. The Financial Integrity Unit that I founded continues to be a model for other corporate investigative programs.

After almost nine years at Microsoft, I returned to consulting in a global investigations and compliance practice at Navigant where I share my best practices and experiences with Fortune 500 companies and other business organizations. My client focus is on conducting internal investigations on behalf of corporate management and boards, Foreign Corrupt Practices Act and antibribery compliance, litigation consulting, due diligence, and corporate compliance design and implementation.

In the past 40 years, I have learned many lessons from fighting fraudsters and fraud around the world, including how to spot the unheeded warning signs and how to understand the criminal mindset. I have distilled these lessons into the resulting best practices in fraud detection, investigation, and prevention that are discussed in this book. There are many different faces of fraud and I have seen most, investigating literally thousands of cases over the years. This experience has allowed me to develop proven strategies for investigation and detection that are backed up with real stories (though in some cases the names of people and businesses have been changed) throughout this book.

One thing is certain. Fraud is evil, with a life of its own that shows no sign of abating. I have seen that evil perpetrated in case after case. As I peeled away the onion of fraud in every investigation, I would find layer upon layer of financial and emotional consequences. I came to recognize this as the hallmark of fraud. Sadly, all that I have seen over the years is an increase in the occurrence of fraud and in the level of victimization. We as a society seem to be unable to learn from our past and continue to fall victim to a multitude of scams and schemes. If only we could see what fraud looks like to better defend against it when it stares us in the face. If only we could do a better job of catching fraudsters and preventing this evil. Thus, when I decided to write a book about my decades of conducting fraud investigations and my associated experiences with fraudsters, Faces of Fraud: Cases and Lessons from a Life Fighting Fraudsters was the logical title.

I have been blessed with an amazing career. Early on, a wise detective told me something I would never forget: that I had chosen the right field of employment and I was very lucky. He said that human greed, naïveté, and fraud would always exist, and as such, I would be guaranteed a full and long employment. He was right; fraud has been my life, figuratively speaking, and I have been able to turn my job into my lifelong hobby. Though some people might consider me an expert, I keep learning every day. I’ve had a lot of wins over the years and also some losses. I am honored to be able to share my fraud-fighting experiences, cases, best practices, and lessons with you.
Chapter 1
The Fraudster Mindset

Learning Objectives

- Identify a common denominator in all boiler room scams
- Recognize an area in which fraudulent activity can be prevented
- Spot the term which refers to a fraudster’s self-confidence for managing the stress that occurs when committing fraud
- Determine what is accomplished through the Addition by Subtraction Theory
- Discern who is often most effective in assisting in a fraud investigation

Introduction

What does a fraudster look like? Can you tell the evil from his or her face? Are there warning signs one can see so as to be on alert? I have been asked these questions over the years. The fact is there is no easy way to look at a person and know for sure their criminal intent. The faces of fraud are everywhere. Fraudsters may be male or female, young or old, short or tall. Fraudsters are your brothers and sisters, friends and neighbors, people from all walks of life and often those you least expect to scheme and scam. If you had come across Bernard Madoff walking the streets of Manhattan prior to December 2008 and his arrest for the mother of all Ponzi schemes, you would have thought you just saw the face of a 70-year-old grandfather out for a leisurely stroll. Certainly not the monster who stole billions of dollars from people who trusted him and in the process destroyed the lives of so many.

Yet there are faces of fraud. They are not in facial characteristics or expressions. They are not in the color of one’s eyes, hair, or skin. Fraud is gender and race neutral. The aura of fraud comes not from how a person looks or where they come from but from their criminal intent and the resulting self-serving actions, ruthlessness, and arrogance. The faces of fraud are personified in the mindset of the swindler. The faces of fraud are felt in the financial, reputational, and emotional impact of their deceptive actions. The faces of fraud are burned into the memories of the victims. The faces of fraud run the gamut from simple schemes that hit and run like advance fee loan scams to long-running and complex financial accounting frauds such as the ones that occurred at Enron, HealthSouth, and WorldCom.

Some scammers are better than other schemers in playing out their frauds. It may be their years of deception or just their personal level of evil. Either way, their success means your loss. Fraudsters have no souls. How else can you explain why they will use every possible lie, deception, and con to defraud you out of your valuables and life savings? Fraudsters are silver-tongued devils who will say and do anything with such convincing words and actions that victims easily fall prey. It is no coincidence that Satan’s appellation is the “Prince of Lies.”

A Silver-Tongued Devil

In 1986, I encountered a young man who was working in a telephone and mail order sales operation that sold rare coins to elderly investors. This particular salesman, although in his early twenties and fairly new at the game, was already an accomplished fraudster. One of his most effective pitches was aimed at elderly women who he would call to sell them grossly overpriced and misrepresented rare coins. When he got such a potential victim on the line, he would tell her that her voice reminded him of his late grandmother. He would say that it was his grandmother who raised him when his own mother abandoned him at birth. He would explain that it was his grandmother who loved him, and sadly died in the last year. The fraud-
ster would tell the potential victim that she reminded him of his “grammy,” and he deeply missed her. He would ask the woman to just talk a bit as her voice eased his pain and brought back loving memories.

What person wouldn’t be moved by such words from a supposedly loving grandson who adored his late grandmother? Many an elderly woman who this con man spoke to believed those words. Except the words were false, all lies, intended to bring sympathy and trust while making the person vulnerable for the close. The scammer would then move in for the kill. He would say that he wanted to do something special for the woman. He would offer her very valuable coins for a fraction of the selling price, but she had to promise not to tell anyone because his boss would fire him for selling the coins so cheaply. It was his way to thank the woman for the good memories she helped him remember.

He would further tell the mark that she should put the coins in a safe deposit box for many years and they would grow in value many times over their purchase price. Then years from now she could give them to her grandchildren as gifts for a college education or keep them to provide for her financial independence. He wanted the victim to put the coins away where no one would see them. If an experienced numismatist who grades coins for a living looked at them, that person would know that the coins were inferior, low grade, and worth a fraction of the price the victim paid. This fraudster was very good at scamming people and would brag about how easy it was to victimize the elderly using his phony deceased grandmother story. His evil eventually caught up with him; I arrested him, and he went to prison on a fraud conviction. He had no remorse until the handcuffs were on his wrists.

Sell the Sizzle, Not the Steak

Few frauds personify the faces of fraud premise better than boiler room scams. Boiler rooms are high-pressure telephone sales operations that target victims using misrepresentations and lies to sell everything from penny stocks to vacation cruises, rare coins to vitamins, and cleaning supplies to Who’s Who memberships. In theory, anything can be sold in a fraudulent telemarketing operation. All that is needed is a good spiel or pitch and a persuasive fraudster delivering it to an unsuspecting victim. The salespeople use aliases or phone names so they have anonymity. Boiler rooms are usually located far from the victim and close down relatively soon after opening, all to lessen the chances of the perpetrators being arrested. All these factors give the operators and salespeople the mistaken belief that they are immune from prosecution.

Present-day boiler room operations are typically located in an office or suite of offices with banks of telephones staffed by telephone salespeople. The common denominators in all boiler rooms are the telephones, misrepresentations, and high-pressure sales pitches. Depending on the degree of evil, boiler rooms may actually provide the victim with the ordered merchandise at grossly inflated prices or in some cases nothing at all. Boiler rooms exist with the proposition of “sell the sizzle, not the steak.” Victims initially fall for the perception of something good and valuable but are eventually left with the realization of deception and loss.

Telemarketing fraud is nothing new. It has been with us since the 1920s when telephone con men contacted investors and sold them worthless stocks and bonds. It was called boiler room fraud, which is the dark and illegal side of telemarketing. The only thing that has changed over the years is that telemarketing fraud has now grown to victimize even more people. We are all affected, but especially the elderly who are particularly targeted by fraudsters. We all want to believe when that telephone rings, we are that special someone who has just won that prize, that trip to the Bahamas, or that investment opportunity that will make us rich beyond our wildest dreams. Unfortunately, all these scam artists do is sell the sizzle and not the steak.

Boiler room operators of the past would often set up shop in the basements of office buildings because the rents were cheap and it was a good place to hide from postal inspectors and other law enforcement officers. These operations would sometimes be in or near the basement boiler rooms, thus the term. But there is another meaning. What is a boiler? It is a device under intense pressure. The same is true in a boiler room. The salespeople are under intense pressure to make sales, and they apply that pressure to their victims. Since the salespeople usually get paid only on a commission basis, they will say and do anything to make a sale. The more they lie and deceive, the more people they can defraud, and the more
money they can make. The red flags of telemarketing fraud as well as other investment scams include these statements made by fraudsters to unsuspecting victims:

- You’ve been specially selected to receive this offer.
- This investment is low risk and provides a higher return than you can get anywhere else.
- We guarantee the results.
- You’ll be rich beyond your wildest dreams.
- It’s so safe that I put my mother into this same investment.
- You’ll get a wonderful free bonus if you buy our product.
- You’ve won a valuable free gift.
- You have to make up your mind right away as this offer expires today.
- We’re members of the Better Business Bureau and authorized by Visa and MasterCard.

When you boil fraud down to its basics, it is all about lying, cheating, and stealing. It’s selling the sizzle and not the steak. Let me explain further. Imagine yourself at a summer barbecue on a warm and sunny day. It’s time to eat, and the host lights the grill to cook the steaks. You are very hungry and you watch the grill heat up. Your host puts on the thick, marbled steaks, and you hear the sizzle. The meat cooks and fat drips, causing the flames to flare. You smell the meat cooking. The juices pool up on the surface of the steaks. Your mouth waters and your taste buds erupt, and you want that steak more than anything. The steak could be tough as leather. It could be the worst piece of meat, but your mind tells you otherwise. You are falling for the perception of a good steak, not the reality of what’s actually on the grill. The same thing happens in telemarketing fraud. Scammers sell you the perception, not the reality.

Dr. Donald Cressey and the Fraud Triangle

Although it is common knowledge that people and corporations commit fraud, it is not fully understood why they do it. Understanding the motive behind fraud is important in preventing it. Dr. Donald Cressey, a famed teacher and pioneer in fraud research and an important fraud expert, developed the Fraud Triangle Theory (Exhibit 1.1) to explain why people commit fraud. Dr. Cressey came to the conclusion that the propensity for fraud occurred when three critical elements came together: motive, opportunity, and rationalization. Each of these three elements is necessary and interrelated in order for a person to actually commit a fraud. The absence of any one of them would not allow a person to commit a fraud. Every corporate executive needs to understand the Fraud Triangle and why employees commit various kinds of fraud. In fact, everyone needs to understand the warnings of the Fraud Triangle to protect against the faces of fraud.

EXHIBIT 1.1 Fraud Triangle

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Financial Pressure and Other Motives

Financial pressure is often the motive for why people commit fraud. It is the element that causes a person to act or react and often implies an emotion or desire.\(^1\) It is the driving force behind a person changing from a law-abiding citizen to one who commits a felony. There are many motivations to commit fraud; most of them are greed related. They include living beyond one’s means, an immediate financial need, debts, poor credit, a drug or gambling addiction, and family pressure, to name a few.

In the movie *Wall Street*, the character Gordon Gekko was fond of saying “Greed is good. Greed is right. Greed works.”\(^2\) Greed epitomized Wall Street in the 1980s. Just as greed led many down the path to insider trading and other financial crimes, it is a motivating force in all kinds of frauds, especially the corporate frauds seen over the last few years. The recent housing bubble and the associated subprime mortgage meltdown, mortgage and securitization frauds, and the resulting devastating impact on the economy, prove once again that greed and fraud are ever-present.

Although greed is the usual motive, sometimes revenge and ego play a role. An employee may feel anger and hostility against a company for some perceived wrong and may try to get back at the company by defrauding it. Although the argument goes that this is revenge, when this behavior results in money in the pocket, it boils down to greed, pure and simple. Sometimes the motive is a desire to beat the system. Fraudsters often think they are smarter than everyone else, and they believe that no one can stop them. Pressure to perform is often a motive for fraud. Sometimes the perpetrator commits fraud to help improve the bottom-line financial results. Emotional instability is also a motivating factor, but this is seen far less than the other motives for fraud.

An excellent example of greed as a motive is a case I investigated involving a multimillionaire industrialist from New York. He owned businesses all over the country. He lived in a mansion in one of Long Island’s most exclusive communities. He gave large donations and endowments to universities, museums, hospitals, and other charitable organizations. Most amazing of all, he served several presidents in a variety of diplomatic and economic assignments in his lifetime. He was well-respected, and reference materials include pages of his accolades and achievements. Compared with all the good this man did throughout his lifetime, the one stain on his career is his conviction for fraud. Unfortunately, he conspired with others to submit a fraudulent insurance claim on one of his many businesses.

Why would this otherwise good man do something that was so contrary to the rest of his life? What was his motive? The answer is simply greed. His path to a courtroom and sentencing before a federal judge started with an insurance claim for damage at one of his factories. The problem was that the type of damage that occurred was not covered by his policy. The damage was in the hundreds of thousands of dollars. Rather than just let it go and view it as a business loss, this industrialist decided to take the advice of his public adjuster and falsify the claim by changing the cause of damage to one that was covered by the policy. Payoffs were made to insurance adjusters to go along with the fraudulent claim. The kickbacks that were paid took almost half of the proceeds from the insurance claim.

This insurance fraud might have gone undiscovered if not for the fact that greed overtook the insurance adjusters involved. They continued to engage in staged and inflated insurance claims with dozens of other insureds and insurance adjusters in settling bogus insurance claims. When I eventually discovered their crimes and confronted them, the adjusters admitted their long involvement in insurance fraud, the many phony claims they had submitted to numerous insurance companies, and the many co-conspirators with whom they had worked. Again proving that there is no honor among thieves, they gave up the name of the industrialist. After a short investigation, the industrialist admitted his involvement and pleaded guilty to charges of mail fraud.

Opportunity

Opportunity is the favorable circumstance that allows a fraud to occur. The degree of opportunity that a person has to commit fraud is usually determined by his or her position of authority in their company and

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access to assets and records. Poor internal controls contribute to opportunity and fraud. An employee who can both open a new vendor account and also pay that vendor provides an example of weak internal controls and a good opportunity for fraud. People who can approve their own expense reports for payment are also provided opportunity for fraud and abuse. Blank check stock that is not properly inventoried and locked is another example of opportunity.

Strong separation of duties, robust internal controls, and constant management oversight reduce the opportunity for fraudsters to commit and succeed at fraud. Of the three Fraud Triangle elements, opportunity is the one area in which fraud prevention can excel. Removing or lessening the opportunity to commit fraud and abuse is important in any fraud prevention program but is absolutely critical for a corporate fraud prevention program.

Scammers commit the frauds they do because they have the opportunity. A mailroom employee may not be able to conspire with a vendor to create a contract that provides no service but yields a kickback to the employee. Yet, a mail clerk could steal incoming mail containing highly confidential proprietary information and sell it to a competitor in a foreign country. It all depends on the opportunity available to potential fraudsters and how that opportunity is limited.

Rationalization

The Fraud Triangle’s third element is rationalization. Rationalization is how the fraudster justifies inappropriate actions. It is “the provision of reasons to explain to oneself or others behavior for which one’s real motives are different and unknown or unconscious.” When the elements of need and opportunity come together, the fraudster is convinced that what occurred is not bad or wrong.

Fraudsters often think of themselves as honest. Rather than considering themselves as criminals who just defrauded their company, they make themselves into victims. They may say: I was only borrowing the money. I’ll pay it back someday; This is not much money, the company is rich and won’t really miss it; Everybody does it; They owe it to me; I’ll stop once I get over this financial hump; It’s for a good purpose; The company mistreats me. Rationalization is another way of saying the end justifies the means.

In my career in law enforcement, I arrested hundreds of fraudsters. None of these criminals ever expected to get caught. They all thought that they would get away with their crimes. They rationalized what they did and came to believe they were invulnerable. If they didn’t rationalize their actions, their consciences would take over.

Fraud Diamond

As further research was conducted into fraud and the fraudster’s motivation, a variation of the Fraud Triangle was advanced. The Fraud Diamond adds the fourth element of capability to the existing elements of motive, opportunity, and rationalization. A person may be in a job function where he or she can commit fraud but their capability to actually carry out the fraud may be limited. Capability includes the fraudster’s personality and traits including knowledge, creativity, and ego that differentiate from opportunity.

While opportunity refers to the person’s role and access to commit fraud, the fourth element takes this one step further. The fraudster “must be intelligent enough to understand and exploit internal control weaknesses and to use position, function, or authorized access to the greatest advantage.” Another aspect of capability is self-confidence and being able to handle the stress that occurs when perpetrating fraud.

Fraud Theories

In addition to the traditional theories of fraud just described, I have designed some theories of my own. Over my many years as a fraud investigator, I have seen more than my share of schemes, scams, cons,
and frauds. Some were simple, such as credit card fraud and loan scams. Others were complex financial crimes such as insider trading, securities fraud, and RICO (Racketeer Influenced and Corrupt Organizations) cases. Some were so well thought out and successful that they were repeated time after time. Although some of these new theories may seem light-hearted and even whimsical at first, they speak volumes about how and why fraud is perpetrated and is all too often successful.

**Tip of the Iceberg Theory**
When first discovered, very few frauds yield their true extent, along with the actual amount of the loss. Often the fraud first seen is just a small part of the actual deceit, like most of an iceberg is hidden below the surface. As an investigator conducts the investigation, interviews people, reviews supporting documentation, and takes other related steps in the process, a much larger fraud is usually revealed. Corporate fraud is no different.

An excellent example of the Tip of the Iceberg Theory of Fraud is an insurance fraud industry case I investigated in the 1990s in New York, which is discussed later in the book. The case started with an anonymous tip to an insurance company that a homeowner’s property claims were fraudulently inflated. One of the first claims I investigated was for $8,000, a rather small amount in terms of insurance fraud that would be authorized for federal prosecution. I believed that multiple fraudulent claims were involved and kept digging. My hard work paid off. By the end of the case several years later, more than 250 defendants had been arrested and convicted, and more than $500 million in staged and inflated commercial and homeowner property claims were uncovered.

**Potato Chip Theory**
Committing fraud and getting away with it can become addictive. Once one succeeds at an embezzlement scheme or payment of a bribe to a foreign government official to secure a contract and gets away with it, it gets harder and harder to stop that activity. This may be characterized as the Potato Chip Theory of Fraud. Just as a person is often unable to eat only one potato chip, once employees start committing fraud, they often cannot stop. Assuming the person does not get caught, he or she will commit fraud after fraud, even branching out to new frauds to obtain more money and other things of value.

An excellent example is a longtime employee of a corporation who was investigated for allegedly receiving kickbacks from a vendor. Applying the Potato Chip Theory of Fraud, other avenues of possible fraud were investigated. Knowing that expense reporting fraud is very common, a review of this employee’s travel and entertainment reports found personal expenses fraudulently claimed as business expenses. Thus, two different frauds against the company were discovered.

Greed and the successful perpetration of fraud become addictive, yet if fraudulent behavior continues, the perpetrator will eventually be found out. Criminals make mistakes no matter how smart they think they are. They get bolder and bolder each time they are not discovered. Experience has taught us that they eventually make fatal mistakes leading to detection. However, employees involved in fraud can do great damage until they are caught. The longer a fraud continues, no matter the employee level, the greater the potential financial and reputational damage. Exhibit 1.2 is a list of many of the behavioral red flags of fraudsters.

**Rotten Apple Theory**
It has often been said that one rotten apple can spoil an entire barrel. This can be applied to unchecked fraud in an organization or group. True leaders can inspire their employees to reach new heights of personal growth and career development. They can be role models who help create a new generation of corporate leaders. Employees want to emulate the leaders they see at their companies. Executives and managers who lead by example in compliance and integrity lessen the risk of fraud by their employees.
Chapter 1 – The Fraudster Mindset

- Living beyond means
- Financial difficulties
- Unusually close association with vendor and/or customer
- Control issues, unwillingness to share duties
- Divorce/family problems
- Wheeler-dealer attitude
- Irritability, suspiciousness, or defensiveness
- Addiction problems
- Past employment-related problems
- Complaints about inadequate pay
- Refusal to take vacations
- Excessive pressure from within organization
- Past legal problems
- Complaints about lack of authority
- Excessive family and/or peer pressure for success
- Instability in life circumstances

EXHIBIT 1.2 Behavioral Red Flags of Fraudsters
Source: Association of Certified Fraud Examiners, 2012 Report to the Nations on Occupational Fraud and Abuse (Austin, TX: ACFE, 2012), 57.

Unfortunately, the opposite also applies. Poor leaders who lack character and integrity, and who turn to fraud and abuse, can damage the people they lead. In a twist on imitation being the sincerest form of flattery, there are examples of employees who turn to fraud because their managers were doing it and getting away with it. This is also called the Culture of Noncompliance Theory because when there is no culture of compliance, a breakdown of rules, policies, and accountability occurs.

A manager committed thousands of dollars of fraud by charging personal expenses on his corporate credit card. He did this on a continuing basis, and his subordinate saw that he did it. The employee copied the fraudulent behavior of his boss. When discovered, the subordinate unsuccessfully claimed that he was just doing what his superior did and should not be fired. This strategy did not work, and both were fired.

Another variation of the Rotten Apple Theory of Fraud is seen when a manager fails to provide adequate supervision of a team, leaving the team members with no direction. When oversight is lacking, successful fraud is easier to commit. Expense reporting fraud is much more common in groups in which it is known that managers do not thoroughly review the submitted payment requests. Although these kinds of managers do not personally commit the fraud, they promote it by not being alert and fully engaged. “Trust but verify” should be an ongoing policy.

Low-Hanging Fruit Theory
Although priority attention should be given to high-risk fraud such as financial misstatement and accounting issues, one must not forget about the lower risk but high occurrence frauds such as procurement frauds. Procurement frauds include invoicing for fictitious goods or services when working with vendors, contractors, and other third parties. It is often thought that fraudsters are cunning, imaginative, and brilliant in devising and executing their many schemes, but this presumption is often a misconception. Investigators, at times, give these violators too much credit for thoroughly thinking through their fraudulent activity and subsequent actions.

The reason that so much fraud is eventually discovered is simply that most fraudsters make mistakes that lead to their discovery. If the “low-hanging frauds” are not given appropriate attention, the fraudster employees will continue their crimes until discovered. This could be months or years, and by that time,
more damage will have been done. Executives should ensure that their fraud investigation units do not overlook these low-hanging frauds, as they will solve several problems.

First, they are usually simple frauds that do not take a significant amount of investigative time. Second, by stopping this fraudulent activity, there is an immediate benefit by removing a bad employee while sending a strong message about the company’s commitment to fraud prevention. Third, the fraudster is removed before he or she is able to commit much more complex and serious frauds.

Addition by Subtraction Theory
One of the best ways to reduce fraud is by removing the source of the problem. When a company terminates an employee who has committed fraud, a risk is removed and that improves the company. This theory refers to the benefits that an organization receives when it takes a proactive approach to fraud detection and investigation. As simple as that may sound in theory, it is often hard to do in practice. It requires a business to take a zero tolerance and hard-core approach to fraudulent behavior by its employees, partners, and vendors. In a case involving embezzlement by a relatively low-level employee, the evidence was overwhelming that the fraud did indeed occur. In addition, the employee admitted his involvement when confronted with the evidence found by investigators.

When the manager was provided with the evidence, he commented that he was sorry he had to terminate the employee because that worker had the potential to be a high-level executive one day. What the manager failed to realize was the Addition by Subtraction Theory of Fraud. The company is best served when a dishonest employee is removed before he or she moves up the corporate ladder where far more damage can be done. If a business is going to have a zero tolerance for fraud, it must apply to all employees. As soon as a high-level executive who commits any kind of fraud is not held accountable, the entire program has lost credibility.

Fraudster as Employee Theory
The employee who commits fraud against the company he or she works for should not be considered an employee. Good employees are critical to the operation of a business. As stated previously, they are ideally concerned about the future of the business, working hard to ensure its growth and future, maintaining integrity, and bettering the company. Fraudsters masquerading as employees use their positions to find weaknesses in the internal controls and exploit them to commit fraud. These people are not out to better the company, other employees, shareholders, customers, or partners. They are only out to line their pockets with ill-gotten gains, and they have ceased to be employees—they have gone into business for themselves. Executives need to understand this concept when dealing with employees who commit fraud.

Short Memory Syndrome
The short memory of society leaves us perpetually vulnerable to fraudsters. Philosopher, poet, and novelist George Santayana said, “Those who cannot remember the past are condemned to repeat it.” Although he was not referring to fraud when he made this statement, it surely applies today. Charles Ponzi created the Ponzi scheme almost 100 years ago, and it has generated untold news stories of deception and shock year after year. Through the various iterations, and untold millions of victims and financial losses, the Ponzi scheme is still going strong. Why is that? Are we incapable of learning from the misfortunes of others when they fall victims to tricks, cons, and fraud? Are fraudsters smarter than honest citizens? Are greed and naiveté too powerful to resist? The Bernard Madoff investment fraud reinforces the Short Memory Syndrome that causes continual suffering.

In a memorable cartoon strip on the first Earth Day in 1971, the title character of the Walt Kelly comic strip Pogo uttered the famous quote, “We have met the enemy and he is us.” Pogo was reflecting on the sad state of the environment and the growing problem of pollution when he made this comment. Yet, Pogo’s timeless quote is just as relevant to our victimization by fraud and how often we enable the fraudsters in committing their crimes. We need to resist the lure of scammers. No one makes huge investment returns every year, especially when the economic markets are in a downward cycle. We need to take re-
sponsibility for fraud prevention, whether on the individual consumer or business level. We need to constantly repeat and remember that if something sounds too good to be true, it usually is.

**Recidivist Fraudster**

It would be unfair to say that fraudsters are incapable of reforming their criminal ways. Many of them have served their sentences and became productive members of society. Still, there are some who on the surface appear to be reformed but who never really get it. Their arrogance, manipulative abilities, sense of being smarter than others, and contempt eventually return them to fraud. They claim that as reformed fraudsters they can best embrace fraud detection and prevention using the French proverb of “Set a thief to catch a thief.” Barry Webne and Steve Comisar are examples of supposedly reformed fraudsters who became fraud prevention speakers and consultants but who in reality continued their recidivist fraudster ways. But Barry Minkow’s egregious behavior may be the most blatant example of this theory.

After serving seven and a half years in prison for orchestrating the ‘ZZZZ’ Best $100 million securities fraud in the late 1980s, Minkow left prison claiming that he had turned over a new leaf. He was an outspoken proponent of holding fraudsters accountable and hosted a national radio show. He founded a fraud investigation firm whose intent was to expose corporate fraudsters. He even became a minister at a church in San Diego. It certainly seemed that Minkow had found a new purpose to his life and had put his fraudulent ways behind for good. Unfortunately, his fall from grace makes him a poster child for the recidivist fraudster.

In 2009, Minkow’s investigative report on home builder Lennar Corporation alleged a massive fraud and Ponzi scheme perpetrated by the company. Lennar’s stock dropped more than 30 percent as a result of the report, causing investors to lose more than $583 million.\(^6\)

In reality, Minkow’s investigation of Lennar was a sham intended to “artificially manipulate and depress Lennar’s stock” to extort money from the builder.\(^7\) His conduct resulted in criminal charges, and on March 30, 2011, he pleaded guilty in federal court in Miami, Florida, to conspiracy to commit securities fraud. In an example of an ultimate betrayal, the criminal complaint alleged that Minkow used his close relationship with the FBI to get them to “open up an investigation into Lennar, and then used his knowledge of the investigation to bet against Lennar’s stock.”\(^8\)

Minkow and most successful fraudsters are charismatic and use their silver tongues to charm and con their victims. Minkow always had a way with words. The federal judge who sentenced him in 1989 recognized it. “You’re dangerous because you have this gift of gab, this ability to communicate, you don’t have a conscience,” stated District Court Judge Dikran Tevrizian.\(^9\) Apparently, the conscience issue was a challenge for Minkow. One reporter wrote that “Minkow’s dealings as a fraud investigator seemed ethically challenged” by shorting “the companies he targeted as a fraud investigator.”\(^10\)

When fraudsters become fraud investigators, it can become a case of the fox guarding the henhouse. The temptation and power without the ethics and character make for a recipe for disaster. At his guilty plea in the Lennar case, Minkow explained to the judge why he committed the fraud. “I’m not too wise, ma’am.”\(^11\) Watch out for the supposedly reformed fraudster who retains the slickness and arrogance, along with the gift of gab. They are red flags of a recidivist fraudster. On July 22, 2011, Minkow was sentenced to five years in prison and $583 million in court-ordered restitution.\(^12\)

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8 Whelan, “Minkow Pleads Guilty.”
10 Ibid.
**Fraudster Mindset**

Fraudsters have a different mindset than honest, law-abiding people. Greed and disdain are prevalent. Arrogance is often a common denominator among fraudsters. Look at Bernard Ebbers, Jeffrey Skilling, Dennis Kozlowski, and the other former corporate titans who became convicted felons. They, like other fraudsters, wrongly believed laws and rules do not apply to them. Fraudsters think they are smarter than everyone else. They never think they will get caught or be held accountable for their actions. In my career in law enforcement, none of the more than 700 defendants I arrested ever thought they would get caught. That is until I placed the handcuffs on them.

Arrogance has been the downfall of many a fraudster. The late Leona Helmsley, who along with her husband Harry Helmsley ran the Helmsley Hotel empire, was called the “Queen of Mean.” Her arrogance and hostile personality were legendary. She was fond of saying that “we don’t pay taxes; only the little people pay taxes.” She falsely wrote off several million dollars in personal expenses as business expenses to fix up her lavish residence. She also extorted gifts and concessions from contractors doing the work. The tax fraud she committed was $8 million, which didn’t make sense since she was worth several billion dollars. She was greedy along with being ruthless and arrogant, and that contributed to her conviction in 1989 and a stint in federal prison for tax evasion.

Sometimes the fraudster mindset is to cut one’s losses and run. Really smart fraudsters know that in some cases, fraud investigators will stop their examination when the fraudster admits his or her misconduct. That was what happened in one of the investigations I managed. An accountant at a company was under investigation for falsifying his résumé. She claimed to have an accounting degree from a prestigious university. The company’s background investigation failed to detect that he never obtained an accounting degree. His poor performance as an accountant caused his manager to question his skills, and it was subsequently learned that the accountant lied on his résumé and employment application about his degree. As soon as he was confronted, he quickly resigned.

There were no other indicatons of wrongdoing by this employee, and his resignation resulted in a closing of the case. It wasn’t until several years later, during an audit of transfer of funds into suspect bank accounts that it was learned the employee had fraudulently transferred hundreds of thousands of dollars into his personal account. The matter was referred to the FBI who confronted the employee and he confessed. He was subsequently sentenced to a prison term and made restitution to the victim company. The lesson to always remember is never to under investigate until you know the full extent of the subject’s possible fraudulent conduct. Cressey’s Fraud Triangle and the element of opportunity as well as the Potato Chip Theory of Fraud are things to remember in each fraud investigation.

The fraudster mindset can also manifest itself in such arrogance that the result is fraudster stupidity. Fraudster arrogance and stupidity are covered in more details in subsequent chapters of this book. Here is an example of such fraudster hubris that his actions made it easy to identify him and determine his involvement in the fraud. When I was a federal agent, I investigated a case involving a scheme to defraud credit card issuers and financial institutions through the submission of fraudulent credit card applications using the U.S. mail. I was notified by several banks and department stores that between February 1 and August 30, 1987, they received credit card applications in the name of Morris Klein that were not submitted by the true Morris Klein.

Each of the many applications listed the same home address in Hempstead, New York, the same home telephone number, the same place of employment, and one of two Social Security numbers. The various banks and department stores mailed credit cards to the address listed on the applications. All of these cards were subsequently used to make purchases. While credit card statements were mailed to the address, only two payments were ever made.

My investigation determined that the home address in Hempstead, New York was not that of Morris Klein. No one by that name lived at that address. The home telephone number used on each fraudulent application was determined to be a test number used by the telephone company. Telephone company installers used this test number to check telephone lines and the number was primed to deliver a busy
signal whenever it was dialed. My inquiry with the employer listed on the applications determined that no one by the name of Morris Klein was employed there.

A tip to one of the victim banks helped identify the fraudster. An anonymous caller stated that a man was using a credit card in the name of Morris Klein to place bets at an Off Track Betting (OTB) parlor on Long Island, New York. The caller stated that he recorded the license plate of the vehicle that the subject had driven to the OTB parlor. The caller advised that the vehicle carried a New York vanity license plate bearing the word SLEUTH.

A vehicle with the SLEUTH license plate was observed parked in front of the Hempstead, New York address listed on the fraudulent credit card applications and where the credit cards were mailed. A check with the New York State Department of Motor Vehicles determined that the SLEUTH vanity plate was registered to Richard Macklin. The address of the vehicle was a post office box in Huntington Station, New York.

The post office box was listed to a collection agency in Huntington Station, where Richard Macklin worked. Macklin stole the personal information of Morris Klein while employed at the collection agency. Macklin was arrested and charged with mail and wire fraud. He subsequently pleaded guilty in federal district court and was sentenced to probation and restitution.13

13 The names of the individuals mentioned in this case study have been changed.
Chapter 1 – The Fraudster Mindset

Review Questions

1. What do all boiler room operations have in common?
   A. Using the telephone to make high-pressure sales pitches
   B. Wheeler-dealer sales pitch
   C. Close connection with vendors
   D. Capability

2. Which statement is a red flag of telemarketing fraud?
   A. This investment is high risk but it provides a higher return than you can get anywhere else
   B. You have three days to make up your mind
   C. We’re members of the Better Business Bureau
   D. We’re not associated with Visa or MasterCard so your credit card cannot be charged

3. Which of the following is not necessary in order for a person to actually commit a fraud?
   A. Perception
   B. Motive
   C. Opportunity
   D. Rationalization

4. What is often the motive for committing fraud?
   A. Opportunity
   B. Rationalization
   C. Financial pressure
   D. Capability

5. What is the one area in which fraud prevention can excel?
   A. Present-day boiler room scams
   B. Opportunity
   C. Rationalization
   D. Motive

6. Which of the following refers to a fraudster’s knowledge, creativity and ego?
   A. Motive
   B. Capability
   C. Opportunity
   D. Rationalization

7. Which of the following is a complex financial crime?
   A. Credit card fraud
   B. Fraud Triangle
   C. Fraud Diamond
   D. RICO case

8. What is characteristic of the Tip of the Iceberg Theory of fraud?
   A. Includes fraudsters who become addicted to committing fraud
   B. Often the fraud first seen is just a small part of the actual deceit
   C. Includes invoicing fraud
   D. Includes fraudsters who commit fraud against their company
Chapter 1 – The Fraudster Mindset

9. Which of the following is a behavioral red flag of fraud?
   A. Maintaining distance from vendors and/or customers
   B. Diligently living within means
   C. Excessive delegation of duties
   D. Refusal to take vacations

10. Which of the following theories applies when a manager’s lack of integrity influences the same behavior in his team?
    A. Rotten Apple Theory
    B. Tip of the Iceberg Theory
    C. Potato Chip Theory
    D. Low-hanging Fruit Theory

11. Which of the following reduces fraud by requiring businesses to take a zero tolerance and hard-core approach to fraudulent behavior by its employees, partners, and vendors?
    A. Rotten Apple Theory
    B. Low-Hanging Fruit Theory
    C. Fraudster as Employee Theory
    D. Addition by Subtraction Theory

12. What is characteristic of the Fraudster as Employee Theory?
    A. Receive a warning and continue with the company as an employee
    B. Employees use their positions to find and exploit weaknesses in internal controls
    C. Commit fraud to better the company and ensure growth
    D. Become repeat offenders due to an addiction to fraudulent activity

13. Which of the following leaves us as a society perpetually vulnerable to fraud?
    A. Trouble with finances
    B. Wheeler-dealer attitude
    C. Instability of life circumstances
    D. Short Memory Syndrome

14. Which of the following often prove to be a valuable asset in detecting fraudulent activity?
    A. Employees who live beyond their means
    B. Employees with a history of employment-related problems
    C. Employees who request more authority
    D. Reformed fraudsters

15. What is often a common element of the fraudster mindset?
    A. Accountability
    B. Arrogance
    C. Compliance
    D. Integrity
Review Answers

1. A. **Correct.** All boiler room operations use the telephone to make high-pressure sales pitches.  
B. Incorrect. Not all boiler room operations use a wheeler-dealer sales pitch. Instead, a person who demonstrates a wheeler-dealer attitude is a red flag of fraud.  
C. Incorrect. Not all boiler room operations include close connections with vendors. Instead, an individual who appears to have an unusually close relationship with vendors or suppliers should be viewed as a red flag for fraud.  
D. Incorrect. Capability is not a common denominator in all boiler room operations. Instead, capability is the element that indicates a fraudster’s ability to execute a scam.

2. A. Incorrect. “This investment is high risk but it provides a higher return than you can get anywhere else” is not a red flag of telemarketing fraud. Rather, a red flag statement would claim to be low risk and high return.  
B. Incorrect. “You have three days to make up your mind” is not a red flag of telemarketing fraud. Instead, a red flag pressures the victim into making a decision right away because the offer is expiring by the end of the day.  
C. Correct. “We’re members of the Better Business Bureau” is a red flag of telemarketing fraud.  
D. Incorrect. “We’re not associated with Visa or MasterCard so your credit card cannot be charged” is not a red flag of telemarketing fraud. Instead, telemarketing fraudsters often claim to be authorized by Visa and MasterCard.

3. A. Correct. Perception is not necessary in order for a person to actually commit a fraud. Instead, as in telemarketing fraud, scammers sell victims the perception, not the reality.  
B. Incorrect. Motive is an essential element in a person’s ability to commit fraud.  
C. Incorrect. Opportunity is necessary in order for a person to actually commit a fraud.  
D. Incorrect. Rationalization is a necessary element in one’s ability to commit a fraud.

4. A. Incorrect. Opportunity is not often the motive for committing fraud. Instead, opportunity provides fraudsters favorable circumstances that allow a fraud to occur.  
B. Incorrect. Rationalization is not often the motive for committing fraud. Rather, fraudsters rationalize their actions to justify the crime.  
C. Correct. Financial pressure is often the motive for committing fraud.  
D. Incorrect. Capability is not often the motive for committing fraud. Instead, capability refers to an individual’s intelligence, knowledge, experience and other supporting strengths that give the fraudster the confidence to commit fraud.

5. A. Incorrect. The present-day boiler room scam is not the one area in which fraud prevention can excel. Instead, depending on the level of evil involved, boiler room scams will go as far as to provide the customer with the ordered merchandise at grossly inflated prices.  
B. Correct. Opportunity is the one area in which fraud prevention can excel. Removing or reducing the opportunity to commit fraud through any fraud prevention program is critical for a corporate fraud prevention program.  
C. Incorrect. Rationalization is not the one area in which fraud prevention can excel. Rather, rationalization provides the fraudster the opportunity to justify his or her fraudulent activity.  
D. Incorrect. Motive is not the one area in which fraud prevention can excel. Instead, fraudsters all have a motive for committing fraud. The challenge and goal is to define a fraud prevention program that will reduce the occurrence of fraud.
6. A. Incorrect. Motive does not refer to a fraudster’s knowledge, creativity and ego. Instead, motive is the driving force behind a person changing from a law-abiding citizen to one who commits fraud.
   B. Correct. Capability refers to a fraudster’s knowledge, creativity and ego. This element of the Fraud Diamond indicates a fraudster’s ability to handle the stress that occurs when perpetrating fraud.
   C. Incorrect. Opportunity does not refer to a fraudster’s knowledge, creativity and ego. Instead, it refers to the person’s role and access to commit fraud.
   D. Incorrect. Rationalization does not refer to a fraudster’s knowledge, creativity and ego. Instead, this refers to the fraudster’s ability to rationalize criminal behavior as good and acceptable.

7. A. Incorrect. Credit card fraud is not a complex financial crime. Credit card fraud is classified as a simple fraud.
   B. Incorrect. The Fraud Triangle is not a complex financial crime. The Fraud Triangle represents the three elements required in every fraudulent activity: motive, opportunity and rationalization.
   C. Incorrect. The Fraud Diamond is not a complex financial crime. The Fraud Diamond takes the three elements of the Fraud Triangle—motive, opportunity and rationalization—and adds capability, a fourth element that represents the fraudster’s overall capacity to execute the fraud.
   D. Correct. RICO (Racketeer Influenced and Corrupt Organizations) cases are considered complex financial crimes.

8. A. Incorrect. It is not characteristic of the Tip of the Iceberg Theory of fraud to include fraudsters who become addicted to committing fraud. This is characteristic of the Potato Chip Theory.
   B. Correct. It is characteristic of the Tip of the Iceberg Theory of fraud that the fraud first seen is just a small part of the actual deceit. Only through the process of investigation is the larger picture of fraud realized.
   C. Incorrect. It is not characteristic of the Tip of the Iceberg Theory of fraud to include invoicing fraud. Instead, this is an example of fraudulent behavior classified as Low-hanging Fruit.
   D. Incorrect. It is not characteristic of the Tip of the Iceberg Theory of fraud to include fraudsters who commit fraud against their company. Instead, this is characteristic of the Fraudster as Employee Theory.

9. A. Incorrect. Maintaining distance from vendors and/or customers is not a behavioral red flag of fraud. Instead, employees with unusually close association with vendors and/or customers are a behavioral red flag of fraud.
   B. Incorrect. Diligently living within means is not a behavioral red flag of fraud. Rather, evidence that an employee is living beyond his or her means is a behavioral red flag of fraud.
   C. Incorrect. Excessive delegation of duties is not a behavioral red flag of fraud. Conversely, employees who are unwilling to share duties may indicate fraud.
   D. Correct. Refusal to take vacations is a behavioral red flag of fraud.

10. A. Correct. The Rotten Apple Theory occurs when a manager’s lack of integrity influences the same behavior in his team.
    B. Incorrect. The Tip of the Iceberg Theory does not occur when a manager’s lack of integrity influences the same behavior in his team. Instead, this theory encourages investigators to look beyond the initial fraudulent activity to detect hidden information.
    C. Incorrect. The Potato Chip Theory does not occur when a manager’s lack of integrity influences the same behavior in his team. Instead, this theory represents the recurring nature of fraudsters to commit crime.
D. Incorrect. The Low-hanging Fruit Theory does not occur when a manager’s lack of integrity influences the same behavior in his team. While high-risk fraud deserves a lot of attention, it is important for investigators to pay attention to low-risk crimes as they have a higher rate of occurrence.

11. A. Incorrect. The Rotten Apple Theory does not reduce fraud by requiring businesses to take a zero tolerance and hard-core approach to fraudulent behavior by its employees, partners, and vendors. Instead, while true leaders can inspire their employees to reach new heights of personal growth and professional accomplishment, the opposite also applies. In this theory, poor leaders can damage the people they lead.

B. Incorrect. Low-Hanging Fruit Theory does not reduce fraud by requiring businesses to take a zero tolerance and hard-core approach to fraudulent behavior by its employees, partners, and vendors. Instead, this Theory refers to low-risk, high occurrence frauds such as procurement fraud.

C. Incorrect. The Fraudster as Employee Theory does not reduce fraud by requiring businesses to take a zero tolerance and hard-core approach to fraudulent behavior by its employees, partners, and vendors. Rather, these are fraudsters masquerading as employees to use their positions to find weaknesses in the internal controls and exploit them to commit fraud.

D. Correct. The Addition by Subtraction Theory reduces fraud by requiring businesses to take a zero tolerance and hard-core approach to fraudulent behavior by its employees, partners, and vendors.

12. A. Incorrect. It is not characteristic of the Fraudster as Employee Theory for employees to receive a warning and then continue with the company as an employee. Rather, employees who commit fraud are no longer considered or treated as employees.

B. Correct. It is characteristic of the Fraudster as Employee Theory for employees to use their positions to find and exploit weaknesses in internal controls.

C. Incorrect. It is not characteristic of the Fraudster as Employee Theory for employees to commit fraud better the company and ensure growth. Employees who commit fraud are only out to line their own pockets.

D. Incorrect. It is not characteristic of the Fraudster as Employee Theory for employees to become repeat offenders due to an addiction to fraudulent activity. Instead, this is characteristic of the Potato Chip Theory.

13. A. Incorrect. Trouble with finances does not leave us as a society perpetually vulnerable to fraud. Instead, financial trouble is a behavioral red flag of fraudsters.

B. Incorrect. A wheeler-dealer attitude does not leave us as a society perpetually vulnerable to fraud. Instead, this is a behavioral red flag of fraudsters.

C. Incorrect. Instability of life circumstances does not leave us as a society perpetually vulnerable to fraud. Instead, behavior resulting from this type of situation typically serves as a red flag for fraud.

D. Correct. Short Memory Syndrome leaves us as a society perpetually vulnerable to fraud. Our tendency to forget about the damage fraudsters have done assists in maintaining the repetitiveness of fraud.

14. A. Incorrect. Employees who live beyond their means do not prove to be a valuable asset in detecting fraudulent activity. Instead, employees who live beyond their means may be sending up a red flag of fraud.

B. Incorrect. Employees with a history of employment-related problems do not prove to be a valuable asset in detecting fraudulent activity. Instead, employment-related problems often signify fraudulent behavior.
C. Incorrect. Employees who request more authority do not prove to be a valuable asset in detecting fraudulent activity. Rather, requesting more authority may be a red flag that the employee wants to be in a role that facilitates fraudulent activity.

D. Correct. Reformed fraudsters often prove to be a valuable asset in detecting fraudulent activity because they are in tune with fraudulent behaviors, techniques and contacts.

15. A. Incorrect. Accountability is not a common element of the fraudster mindset. Rather, fraudsters do not believe they should be accountable for their actions.

B. Correct. Arrogance is often a common element of the fraudster mindset. Because of arrogance, fraudsters wrongly believe laws and rules do not apply to them.

C. Incorrect. Compliance is not a common element of the fraudster mindset. Instead, according to the Culture of Noncompliance Theory, fraudsters thrive when there is no culture of compliance, rules, policies or accountability.

D. Incorrect. Integrity is not a common element of the fraudster mindset. Instead, the lack of integrity is a red flag of fraud.
Chapter 2
A Short History of Fraud in America

Learning Objectives
- Identify what is crucial to an investigator’s ability to recognize red flags and embrace best practices in preventing fraud
- Recognize the meaning of grafter
- Pinpoint the true motivation behind fraudsters’ actions
- Identify the weapon of choice in stopping widespread fraud

Introduction
Sadly, fraud has a long and storied history in America. There is the saying “Everything old is new again.” That definitely applies to the incidence of schemes and scams taking place in the world of fraud. Old fraud schemes are continually being resurrected to defraud consumers and businesses out of billions of dollars. Whether it is a Ponzi scheme, corporate accounting fraud, advance fee swindle, or a boiler room scam, they all began many years ago and continue to claim victims today.

As a society, we have faulty memories when it comes to fraud. Although fraud schemes are usually the subject of intense media scrutiny and reporting, once the headlines fade, we often forget the warning signs and allow ourselves to fall victim again. Is it that human frailty, naïveté, and greed are too great for society to overcome? It sometimes seems that way, as efforts in education and awareness either fail or lose steam once the focus shifts to the next major headline.

One trait that all successful fraud investigators need is vigilance. In this chapter you will find just a small sample of historical mail fraud cases that reinforce the importance of vigilance in recognizing red flags and embracing best practices in preventing fraud. The Ponzi scheme is a vivid example of where we failed to learn from history, and consequently suffered huge financial losses as well as significant emotional impact. The Bernard Madoff fraud could have been avoided had we simply remembered the lessons learned from Ponzi.

Growth of Mail Fraud
Long ago, swindlers realized the value of the postal system for perpetrating scams. It started with the advent of the railway mail service in the 1830s, as new mail routes established across the country enabled businesses to expand customer networks and engendered a subsequent growth in the mail order business. Mail order businesses offered consumers access to numerous goods delivered right to their doors. Unfortunately, it also offered a golden opportunity for con men and scam artists who quickly saw how easy and profitable it was to use the mail to conduct fraud schemes. Misleading advertisements and unordered merchandise became major problems for victimized consumers. Fraudsters had the run of the land, scamming and defrauding all they could find.

In the 1860s, a rash of swindles erupted, including phony land sales and lottery promotions. Scams continued to flourish in the years after the Civil War, including phony gold mines, watch and jewelry swindles, medical quackery, and investment rackets. Fraudsters developed counterfeit money schemes where they sold articles which were commonly called in the language of the day green articles, green coin, green goods, bills, paper goods, spurious Treasury notes, United States goods, and green cigars. Con men assembled sucker lists containing the names of victims and potential victims and sold them to other con men. These con artists operated throughout the country. They were virtually immune from prosecution because they were usually outside the jurisdiction of local law enforcement and the federal Mail Fraud Statute had not yet been enacted.
Green Goods Swindles

The most common fraud scheme in the late-1800s through the turn of the twentieth century was the green goods swindle. These scams, using several variations, promised top-quality counterfeit money at a discount. One scam offered money that was supposedly printed from stolen Treasury Department plates. A gang in New York guaranteed in its mailings that the counterfeit money was “so perfect that it cannot be told from the genuine.”\(^1\) Once the victims mailed in or provided their money, they received a box of sawdust, bricks, or strips of green paper. Often the victims did not complain to authorities because they believed they had participated in a crime in attempting to buy counterfeit money.

An example of a common advertising circular from that era read:

*My Dear Sir: I am desirous of obtaining a good shrewd agent in your locality to handle my “goods.” I enclose herewith a newspaper clipping, which gives all the information that could be desired, and which explains itself. Thinking you are in a position to safely handle my goods, I have concluded to write you. If you don’t care to invest in this enterprise, I hope you will excuse the liberty I have taken in making the proposition. If you have been unsuccessful in your business, I can supply you with goods with which you can pay off all your debts and start free and clear again. You can purchase mortgages, etc. An opportunity like this to make an independent fortune has never crossed your path before and in all probability never will again as long as you live. It was never intended that one man should have millions of dollars and another nothing, so you don’t throw away this chance to get riches. Others have grown rich around you, no one knows how. Why not help yourself? If you have not the ready money to purchase my goods, I would consent to your taking some confidential friend in with you, provided, of course, he is trustworthy and could keep a secret. You can both come on together and make the deal. However, you would be very foolish to take anyone in with you if you could raise enough money yourself. If you conclude to embrace this “golden chance” and my business should suit you, it will be absolutely necessary for you to come here and see me in person. I only deal face to face with my customers.*\(^2\)

Another said:

*Dear Sir: I am in possession of a good thing, and wish your confidential and friendly cooperation in a scheme which, if grasped now, will make you independently rich, and will at the same time better my own condition. The enclosed newspaper clipping gives some very interesting particulars. Read it.*\(^3\)

These green goods scam artists would routinely include bogus newspaper clippings in their mailings to support their fraudulent claims. The newspaper clippings claimed to be from the *New York Sun* and the *New York Times* and falsely detailed how these schemes were perfectly legal and immune from prosecution. The newspaper clippings had headlines such as “An Easy Way to Get Wealth: Greenbacks Just as Good as Genuine” and “A Counterfeiter Goes Free.”

Fraudsters operated these scams for years and in the process defrauded many people. James McNally was an unrelenting swindler who was called the “King of the Green Goods Men” and operated for 15 years until he was convicted and sentenced to prison in 1896.

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\(^2\) Ibid., 566.

\(^3\) Ibid., 567.
Grifters
By 1900, an organized syndicate of con men emerged with a new strategy. Grifters, such as those made popular in the movie *The Sting*, set up elaborate cons in cities throughout the country. One such con man, Buck Boatwright, developed an operation using a storefront as his base. He picked Webb City, Missouri, because he was able to pay off the local police and politicians there. His operation became known as the big store, which meant a wide-open town where anything goes. His schemes involved fixed gambling and sporting events.

After Boatwright died, John C. Mabray became a leading figure in the big store concept. Mabray opened his operation in Council Bluffs, Iowa, and named it the Millionaires’ Club. He targeted farmers, merchants, miners, ranchers, bankers, and lawyers in his elaborate stings. In 1909, Mabray was arrested with other conspirators. A search of his premises yielded evidence of more than $5 million taken in over the years by the group, as well as a ledger listing all the other confidence men associated with Mabray. This ledger detailed the schemes that each was involved in, the victims’ names and addresses, and the amounts taken. Postal inspectors throughout the country began to investigate these other grifters. Mabray and 10 others were found guilty after a jury trial, and were sent to prison. Eventually, 50 of these con men were convicted as a result of inspectors’ investigations.

Baker Heirs’ Swindle
One scam started in 1896 would run until 1937 while victimizing untold thousands of people with an estimated loss of more than $1.5 million dollars. The fraud began when numerous individuals claimed to possess proof that they were heirs of the Baker family, who resided in Pennsylvania during the early part of the nineteenth century, and were entitled to share in vast holdings of money and real estate that amounted to a billion dollars.

Allegedly, Jacob Baker enlisted as a surgeon in the Continental Army during the Revolutionary War, and as a reward for his services supposedly received extensive land grants. Accordingly, Baker left a will dated December 27, 1839, bequeathing 11,000 areas of land bearing valuable coal, lead, and zinc deposits. In addition, it was also claimed that many properties in the heart of Philadelphia including Independence Hall, Franklin Square, the Post Office, and the U.S. Mint were owned by Baker’s heirs. Fraudsters solicited money through the mail for the purpose of probating the alleged will. If the person solicited could be convinced that he or she was a Baker descendant, they were sold a share in the mythical estate. Other groups solicited enrollments at 10 or 20 dollars each, in addition to memberships in Baker Heir Associations, which collected monthly dues.

Postal inspectors started investigating these schemes in 1902 and for many years had little success in stopping them, but with steadfast determination they finally ended the scheme. They obtained the purported will and conducted chemical and handwriting analysis. They found that the paper on which the will was written was not manufactured until 1890—the paper had been artificially aged. The signatures of the witnesses to the will were also forged. Inspectors searched the land title records of every county in Pennsylvania from 1862 to 1937, and their extensive search proved conclusively that no such estate ever existed. Inspectors also proved that there was no Jacob Baker from Pennsylvania who had served as a commissioned officer in the U.S. Army or Navy during the Revolutionary War. Furthermore, the U.S. government had made no land grants to any Baker in Pennsylvania on account of wartime service. Inspectors exposed these long-held rumors as false and obtained the convictions of 24 individuals.

Golden Age of Fraud
The Roaring Twenties ushered in the golden age of fraud with such legendary con men as Charles Ponzi, Joseph Weil, Oscar Hartzell, and others challenging law enforcement, and victimizing the naïve, unsuspecting, and greedy. These fraudsters became larger than life in executing their schemes and left indelible marks on their victims and on history. Their unique and brazen ways to commit crime added new faces of fraud.
Chapter 2 – A Short History of Fraud in America

Charles Ponzi
Charles Ponzi came to the United States from Italy at the turn of the last century. In Boston in 1919, he developed what would be forever known as the Ponzi scheme. The scheme, simply put, was robbing Peter to pay Paul. Ponzi claimed he could buy International Postal Reply Coupons from foreign countries and then redeem the coupons in the United States at a substantial profit due to differences in exchange rates. Ponzi gave personal notes as security for investors’ money and promised a 50 to 100 percent return in 45 to 60 days. This investment opportunity was a total scam, but the lure of quick fortunes caused thousands to invest their money. By paying the initial investors with money from the new investors, Ponzi created an investing frenzy in this country. Ponzi promised that investors would make millions, but when this scheme came crashing down, it was the investors who lost millions. In just seven months, more than 30,000 victims paid him more than $9 million.

By 1920, he owned 200 suits, 100 pairs of shoes, 24 diamond stickpins, numerous limousines, and a mansion. He purchased his old employer’s business, and then with $3 million in cash bought a controlling interest in Hanover Trust Company. On August 13, 1920, the Boston Globe ran an exposé on Ponzi and the scheme, warning the public of falling into Ponzi’s trap. Frantic investors mobbed his office demanding their money back.

Subsequently, Ponzi was arrested and charged by both the District Attorney’s Office and the U.S. Attorney’s Office. Ponzi paid back some money but then fled with several million dollars. He was caught, sent to prison, and eventually was deported to Italy, but this didn’t stop him. Years later, he convinced Italian dictator Benito Mussolini to give him a position in the Italian Treasury Department. True to form, Ponzi cleaned out a large sum from the treasury and fled to South America where he died in 1949. Ponzi left a legacy of fraud, as his Ponzi scheme continues today.

Joseph “Yellow Kid” Weil
The king of the flim-flam men was Joseph “Yellow Kid” Weil, who took his nickname from a popular cartoon character of the day. Weil was a legendary con man whose schemes made him millions over the years. He was a very active fraudster from 1900 until at least 1940. Weil was a master grifter with an extensive arrest record. Among his many prosecutions was his conviction as a member of John Mabray’s gang in 1911.

Weil peddled phony stocks, sold worthless land, fixed horse races, and conducted any scam he could. His frauds were legendary, and he became very wealthy. He once fired a shotgun loaded with gold pellets into the walls of an abandoned quarry and then sold stock in the “gold mine.” He salted a stretch of the Chicago River with gold and sold mining rights to unsuspecting victims. His swindles were also committed internationally. He posed as a representative of the German government to scam a Missouri banker with phony stocks. He rigged prize fights, sold nonexistent timber rights, and claimed to represent a London oil trust.

He claimed to target only the greedy and rich in his schemes. He argued that they had the benefit of the best educations and should know better than to fall for his cons. After one of his arrests, he boasted about why he conned people. “The men I swindled were also motivated by a desire to acquire money, and they didn’t care at whose expense they got it,” he said. “I took money only from those who could afford it and were willing to go in with me in schemes they fancied would fleece others.” Although Weil conveniently claimed to rob only from the rich, the truth is that fraudsters will steal from anyone who is naïve, trusting, and has money.

Weil debunked the idea that fraudsters should use their intelligence and imagination for the greater good of mankind. “The notion that any swindler would be a great success if he turned to legitimate channels is indeed erroneous,” he was fond of saying. He even argued that he was teaching his victims not to fall for future frauds as a result of him defrauding them. Clearly, this did not provide any solace to his

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5 Ibid., 292.
many victims. Weil’s decades of criminal activity are proof enough that fraudsters do not easily change their ways. To use their skills for good is alien to scam artists, as they would much rather employ their evil ways to line their pockets. Weil died in 1976 at the age of 100.

Oscar Hartzell
The Sir Francis Drake inheritance scam ran from 1924 until 1933. It started when an Iowa farm boy’s mother was scammed in a phony inheritance scheme. This farm boy, Oscar M. Hartzell, thought that if his mother could fall for such a scheme, many other people would also fall victim. Hartzell realized the huge financial potential of this racket. The Sir Francis Drake Association was the result. Drake was the first Englishman to circumnavigate the globe. He died in 1596.

Hartzell and his confederates dreamed up the Drake fortune, which with accumulated interest of over 300 years was then worth $22 billion. Victims were told that they were heirs to the fortune but would have to invest money for legal work to prove the claims. Initially, the fraudsters targeted people with the surname of Drake in the United States and then Canada. Each victim had to pay to become a member of the Sir Francis Drake Association in order to share in the vast estate. Then the victim would be told that additional monies were needed to secure the inheritance.

When the Postal Inspection Service began the investigation, it found some victims uncooperative because they still believed they would be receiving their inheritance. Inspectors tracked Hartzell to London where he was living. It was learned that the swindlers collected over $1 million, from 70,000 people, in a 9-year period. Inspectors traveled to England and located the actual will of Sir Francis Drake. Hartzell was subsequently deported from England in 1933 to face trial in the United States. He was convicted and sentenced to 10 years in prison. The con man’s charisma and manipulation were so strong that some of the victims refused to believe they had been defrauded and even contributed to his defense.

Rise of Boiler Rooms and Bucket Shops
The 1920s gave rise to the phenomenon of bucket shops and boiler rooms, and they have been a thorn in the side of consumers and law enforcement ever since. Bucket shops were offices where individuals gambled in the stocks, bonds, grains, or other commodities sold on exchanges. In bucket shops, brokers took victims’ money but never bought the ordered equities. This was called “bucketing” the order. Fraudsters figured that the speculative stock would fail, and victims would never know their orders hadn’t been placed. If by chance the stock didn’t fail, the fraudster would change the operation’s name and simply move to another location to repeat the scam.

In 1924, a bucket shop operation in Boston that falsely promised to buy stock was investigated by postal inspectors and prosecuted. More than $10 million was lost in this scheme. Boiler rooms evolved from these bucket shops, and they involve selling a variety of misrepresented products and investments. I investigated dozens of boiler room schemes, and many of those case studies are in later chapters of this book.

The 1920s saw numerous oil industry merger investment schemes in Texas, Arkansas, and California. Victims were solicited to invest in defunct companies with false promises that the companies were about to merge with other well-known firms—the victims lost more than $82 million in these schemes.

According to Elinore Denniston’s book America’s Silent Investigators: The Story of the Postal Inspectors Who Protect the United States Mail, Post Office inspectors believed that the sale of phony oil stocks between 1919 and 1928 played a role in the Wall Street crash of 1929 and the Great Depression.

Other Frauds Over the Years
Other scams during the 1920s and 1930s included the sale of Florida Everglades swamp land, faked dog pedigrees in the sale of hunting dogs, correspondence school fraud targeting farmers and young men just out of high school, and how to be a detective by mail schemes promising employment as a private detective.
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Work-at-home schemes became more commonplace after World War II and flourished in the 1950s. The schemes were endless: mushroom raising, chinchilla breeding, bead stringing, plastic laminating, and artificial flower making were but a few of these numerous scams. Envelope stuffing became a major work-at-home scheme. One operator was running 44 related companies promoting everything from Angora raising to a vanity press.

One of the most successful work-at-home operators was Nels Irwin, who began operating in California in 1953. Irwin sold miniature trees, tropical fish, molding machines for plastic novelties, and other items. Postal inspectors estimated that he made over $3 million before he was prosecuted, convicted, and sent to prison for three years. Postal inspectors were unable to find a single customer who had made money on any of Irwin’s promotions.

During the early 1950s, deceptive contest promotions were common. Among them were mail fraud schemes involving free diamonds as prizes. The premise was that contestants were to count the number of diamonds in a jar or small container and mail in a card with their guess. All who entered usually were informed they were winners and were told they had won a valuable diamond, which in reality was worth only a few dollars. The diamonds were of a poor quality and did not include the settings. The main objective of the scheme was to get the victims to trade in their diamonds for more expensive ones in a classic bait-and-switch scheme.

The 1950s also saw the spread of medical quackery affecting both victims’ pocketbooks and their health. One of these promoters was Cora Galenti, who ran a so-called beauty ranch. She promised “new faces for old” to women looking for the fountain of youth. She used the mail to advertise the Cora Galenti Method of Facial Rejuvenation using dangerous carbolic acid to remove wrinkles, crow’s feet, blemishes, and the effects of aging. Rather than restoring women’s faces to their youthful state, these unsuspecting women were instead left with horrible scarring. Galenti was eventually convicted on mail fraud charges and received a 5-year prison term. Justice was denied when she jumped bail prior to her incarceration and left the country.

The 1960s continued the menace of medical frauds, including alleged cures for cancer, arthritis, and rheumatism, as well as worthless potions, beauty and diet products, rejuvenators, and sexual devices. One famous promoter at the time was “Dr.” Roy Dewelles who operated clinics, performed medical diagnoses, and sold the Detoxacolon device. The Detoxacolon was nothing more than colonic irrigation applied under pressure and was not only useless but could also cause serious health complications. Dewelles claimed he could cure numerous diseases, but nothing could be proven. He was investigated and imprisoned on mail fraud charges.

Unfortunately, medical frauds continue to plague the public. We are constantly bombarded with advertisements promising to help enhance sexual performance, grow hair, lose weight, and help us live healthier lives. Many of these ads appeal to the public’s vanity and, in fact, do very little to fulfill any of the representations promised.

A notorious case that received international publicity in the 1970s was the Clifford Irving literary hoax. Clifford Irving was an author and con man who defrauded two major New York publishing houses out of hundreds of thousands of dollars when he sold them a lurid biography of reclusive multimillionaire Howard Hughes that proved to be an expensive hoax. Irving falsely claimed that Hughes had given him exclusive rights to pen his biography. The investigation took law enforcement throughout the United States, Mexico, Puerto Rico, the Bahamas, Switzerland, and Spain. A key piece of evidence was a letter addressed to Irving from Hughes supposedly authorizing Irving to sell the biography to a publisher. Postal inspectors obtained handwriting samples, and with the assistance of the Inspection Service Crime Laboratory proved that the Hughes letter was a forgery. This helped to convict Irving in New York in 1972.

Also in 1972, the Trans-Continental Casualty Insurance case was considered one of the largest frauds ever prosecuted at the time. The defendants used the financial resources of Trans-Continental, backed by the fraudulent Bank of Sark based in the English Channel Island of Guernsey. The defendants collected fees for nonexistent loans. This case was investigated by postal inspectors and resulted in 22 defendants being charged in Miami, Florida. Losses to businesses and investors exceeded $100 million.
Rebate fraud has long been an avenue for industrious scammers. In 1977, postal inspectors initiated an investigation to determine the scope of fraudulent redemption of cents-off coupons by retailers in the New York metropolitan area. Inspectors created a nonexistent laundry detergent named Breen along with a bogus cents-off coupon valued at 25 cents. Additionally, a redemption center was established under the name Coupon Fraud Control Program to act as the redemption agent for anyone wishing to fraudulently redeem the coupons. The Breen coupon was included in coupon inserts in major New York area newspapers in December 1977.

Although the bogus Breen coupon was advertised for one day in two states, over 77,000 coupons were eventually redeemed by over 2,100 retailers located in 42 states. Subsequently, more than 200 merchants in New York and New Jersey were charged with mail fraud as a result of the Breen investigation. This innovative investigation proved to the industry that coupon redemption fraud was an even more serious problem than previously thought. A rebate fraud investigation I conducted is found in Chapter 7 of this book.

Ivan Boesky and Michael Milken represented the age of greed on Wall Street in the 1980s. They were implicated in insider trading schemes that led to both men being charged with mail fraud and multiple securities violations. Boesky cooperated with the government and became an informant against Milken and others. He was sentenced to 3½ years in prison and a fine of $100 million. Milken was originally sentenced to 10 years in prison but served less than 2 years due to his cooperation against other defendants. Milken’s fines and penalties totaled $150 million. Numerous others were also arrested for insider trading and securities violations. The movie Wall Street fictionalized insider trading and the massive fraud that resulted.

In the 1980s, Jim Bakker, alongside his wife, Tammy Faye Bakker, gave many a tearful performance while promoting the Praise the Lord Club on morning television. Millions of people tuned in to listen to Bakker praise the Lord and Tammy Faye sing, smile, or cry, all the while asking for money for their religious crusade. Bakker made millions of dollars by selling partnerships in his Heritage USA hotels. For a $1,000 contribution, Bakker promised a partnership and free vacation at the planned hotel at the Heritage USA theme park every year. The partnerships were supposed to end once 25,000 were sold, but Bakker sold 153,000 and converted the investors’ money for his personal use. The scheme brought in $178 million from investors. One may remember the gold-plated bathroom fixtures in Bakker’s house and the air-conditioned doghouse built for the family pet. Bakker and three co-conspirators were convicted in Charlotte, North Carolina, of mail fraud in 1989. Bakker was sentenced to 45 years in prison and a $500,000 fine. This was the culmination of a 2½-year joint federal law enforcement investigation.

Dr. Cecil B. Jacobson was a nationally known fertility specialist who defrauded patients and insurance companies by prescribing unnecessary treatments, needlessly prolonging care, and falsely representing that he was obtaining donor sperm to impregnate patients. In fact, he was fathering babies with his own seed. He was convicted in Alexandria, Virginia, in 1992 on 52 counts of mail fraud. After his conviction, a newspaper cartoon pictured the double-chinned Jacobson standing outside a hospital nursery, staring ruefully through the nursery window at 52 double-chinned infants, all wearing his distinctive wire-rim glasses.

James C. Cacheris, the chief U.S. district court judge who presided over the trial, said upon sentencing Jacobson that in his many years on the bench he had “not seen a case the equal of this one in terms of the degree of emotional anguish, psychological trauma and, at times, profound despair expressed by those victims who took the witness stand and/or wrote to the court to communicate their experiences with the defendant.”

Recognizing that the fraud sentencing guidelines were money driven, he departed from normal guidelines and incarcerated Jacobson for additional years. Long after this case faded from America’s collective memory, Jacobson’s victimized patients were left to deal with the psychological aftermath and the persistent feelings of utter hopelessness.

In 1992, John McNamara, a well-known Long Island, New York, car dealer, pleaded guilty to mail and wire fraud charges related to a scheme that defrauded General Motors Acceptance Corporation

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(GMAC) out of $6 billion. McNamara admitted to borrowing billions from GMAC to finance vehicles that did not exist and funneling the money into a $435 million business empire built in part on bribery and fraud. The defendant converted most of the $435 million for his own use, which he then invested. The balance of the loan proceeds was used to pay the principal and interest to GMAC on the existing loans in a classic Ponzi scheme.

Edward “Crazy Eddie” Antar was the head of Crazy Eddie’s, a New York and New Jersey electronics store chain. Its abrasive advertising slogan was screamed over the airwaves—"Crazy Eddie’s prices will drive you INSAAAAANE!" Antar submitted false corporate financial statements to the Securities and Exchange Commission as part of his fraud scheme, which succeeded in inflating the value of his and other defendants’ stock holdings and netting them $80 million when the stock was sold. Postal inspectors joined with other federal agents in this complex investigation. Antar was convicted in 1993 for conspiracy and mail fraud, but he fled to Israel and became a fugitive for several years. He was located and eventually returned to the United States and incarcerated.

Hilda Amiel and her daughters flooded the national art reproductions market with thousands of fraudulent lithographs of art works purportedly created by Salvador Dali, Joan Miro, and Pablo Picasso, as well as by celebrity artists such as Red Skelton and Henry Fonda. Postal inspectors throughout the country worked this high-profile case. Amiel died while awaiting trial, but her three daughters were convicted in 1993.

Irwin “Sonny” Bloch was a popular radio financial talk show host who duped his audiences out of over $21 million, recommending investment opportunities that actually were set up to enrich him and his co-conspirators. Bloch pleaded guilty to separate mail fraud and securities violations in New York and New Jersey in 1996. When Bloch’s plea was entered in Newark, the prosecuting attorney referred to Bloch as a syndicated talk show host turned syndicated scam artist. Bloch and numerous co-defendants were convicted. Bloch was sent to prison but was released when he was diagnosed with terminal cancer. He died in 1998. I investigated this case, and it reinforced my opinion of the appeal and power that media celebrities can have over their followers.

In New York in late April of 1999, Lawrence X. Cusack III was convicted of 13 counts of mail and wire fraud in a sensational trial that could have come out of today’s tabloid headlines. Cusack was found guilty of forging and selling scandalous documents claiming that President John F. Kennedy paid hush money to keep an affair with Marilyn Monroe secret. Over the years, Cusack made a fortune selling Kennedy letters and documents that he said were the property of his late father. The documents claimed to prove the rumors about a relationship between John F. Kennedy, Robert Kennedy, and Marilyn Monroe, and the late president’s involvement with organized crime. Proving that criminals are often as dumb as they are brilliant, one letter supposedly signed by President Kennedy contained a ZIP code, which did not exist at the time the letter was dated. Cusack defrauded investors out of $7 million in a 4-year period and was sentenced to 10 years in prison.

Enactment of the Mail Fraud Statute

In 1866, U.S. Senator James Dixon introduced a bill to protect the postal system from those who would use the mail for fraud. While this bill never left the committee, it brought much needed attention to the growing problem of mail fraud. By 1868, the mail was commonly being used by scam artists for fraudulent lotteries and gift schemes, as well as for obscene materials. In response, that year Congress enacted legislation prohibiting the use of the mail to send letters or circulars for lotteries or prize giveaways. The exact language of the act said that it shall not be lawful “to deposit in a post office, to be sent by mail, any letters or circulars concerning lotteries, so-called gift concerts, or other similar enterprises offering prizes of any kind on any pretext whatsoever.”

This legislation had little impact, partly because of the vagueness of the statute and the reluctance on
the part of postal employees to assist in enforcing the act. This was due to a law that was passed in 1836
imposing harsh penalties on postal employees for unlawfully detaining letters. Therefore, postal employ-
ees were not willing to enforce the statute and face possible punishment.

When it became time for more definitive action the Mail Fraud Statute was envisioned. Representa-
tive John Franklin Farnsworth of Illinois was the House sponsor of the Mail Fraud Statute. He served 14
years in Congress and eventually rose to chairman of the Post Office and Post Roads committee. Con-
gressman Farnsworth introduced the mail fraud bill to protect against fraud through the mail and specifi-
cally counterfeiters, illegal schemes, and forgeries. He stated at the time that the purpose of the mail fraud
statute was “to prevent the frauds which are mostly gotten up in large cities by thieves, forgers, and rap-
scallions generally, for the purposes of deceiving and fleecing the innocent people in the country.”
Farnsworth’s bill failed to be enacted by the 41st Congress in 1870 but was later reintroduced during the
42nd Congress in 1872.

An unidentified congressional sponsor at the time stated: “Thus, all through the country thousands of
innocent and unsophisticated people, knowing nothing about the ways of these city thieves and robbers,
are continuously fleeced and robbed, and the mails are made use of for the purpose of aiding them in their
nefarious designs.”

On June 8, 1872, the 42nd Congress did revise, consolidate, and amend the statutes relating to the
Post Office Department, and the Mail Fraud Statute was finally enacted. The new Mail Fraud Statute
stated “any person who shall, by fraud, or deception, obtain from any person having custody thereof, any
such mail, letter or packet containing any such article of value aforesaid, every such person, not being
employed in any department of the postal service, shall, on conviction thereof, for any offense, be impris-
oned at hard labor not less than one or more than five years.”

This new weapon was now ready to be used by postal inspectors and federal prosecutors in the war on
fraud. The Mail Fraud Statute is the weapon of choice in stopping widespread fraud, and it holds a unique
place in the proud tradition of the U.S. Postal Inspection Service. The use of the Mail Fraud Statute, along
with other federal antifraud statutes, has continued to be a powerful tool for prosecution of fraudsters. As
current federal judge and former federal prosecutor Jed S. Rakoff wrote in 1980, “To federal prosecutors
of white collar crime, the mail fraud statute is our Stradivarius, our Colt .45, our Louisville Slugger, our
Cuisinart—and our true love.”

The Continuous Onslaught of Fraud

In my 40 years as a fraud investigator, I have yet to see any decrease in the incidence of fraud. If any-
thing, I have witnessed a continuous increase in the frequency of schemes and associated fraud losses
victimizing people and businesses, by individual scam artists and corporate fraudsters. Ever-scheming and
imaginative fraudsters dust off old frauds from the past and commit them with new twists to defraud an
unsuspecting public. Fraudsters leverage technology and the Internet to develop new swindles. We have
seen the growth of fraud over the last two centuries and can expect a continuation well into the future. As
Judge Edwin R. Holmes said in the U.S. Court of Appeals case of Weiss v. United States in 1941, “The
law does not define fraud; it needs no definition; it is as old as falsehood and as versatile as human inge-
nuity.” To better fight fraud, we must understand and recognize the faces of fraud.

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Review Questions

1. Which of the following applies to the incidence of schemes and scams taking place in the world of fraud?
   A. Everything old is new again
   B. Spurious Treasury notes
   C. Robbing Peter to pay Paul
   D. Bucketing

2. Which of the following is crucial for an investigator to succeed?
   A. Understanding of green cigars
   B. Vigilance
   C. Understanding that, given the opportunity, all fraudsters would succeed in legitimate activities
   D. Comfort in the art of manipulation

3. What is the green goods swindle?
   A. Organized syndicate of con men operating elaborate scams from an every-day storefront
   B. The most common fraud scheme in the late-1800s that promised top-quality counterfeit money at a discount
   C. Scam in which fraudsters convinced individuals they were heirs to the non-existing fortune of Jacob Baker, a surgeon in the Continental Army during the Revolutionary War
   D. Investment scam that involved paying initial investors with money from new investors.

4. Which of the following claimed the ability to purchase International Postal Reply Coupons from foreign countries and then redeem the coupons in the United States at a substantial profit due to differences in exchange rates?
   A. Ponzi scheme
   B. Grifters
   C. Green articles
   D. Sir Francis Drake inheritance scam

5. Which of the following conducted fraudulent business schemes using a storefront as a base?
   A. Grifters
   B. Green cigar
   C. Baker heirs’ swindle
   D. Joseph “Yellow Kid” Weil

6. Which of the following was known for legendary scams such as firing a shotgun loaded with gold pellets into an abandoned quarry then selling stock in the “gold mine”?
   A. Charles Ponzi
   B. Joseph “Yellow Kid” Weil
   C. Oscar Hartzell
   D. Nels Irwin

7. What is the true nature of fraudsters?
   A. Rob only from the rich
   B. Desire to use intelligence and imagination for the greater good of mankind
   C. Desire to steal from anyone who is naïve, trusting, and has money
   D. Teach victims not to fall for scams in the future
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8. What is a bucket shop?
   A. First organized scam to use the railway mail service for fraudulent purposes
   B. Operation that offered counterfeit money printed from stolen Treasury Department plates
   C. Office where individuals gambled in commodities sold on exchanges
   D. Storefront for medical scams

9. What is the weapon of choice in stopping widespread fraud?
   A. Trans-Continental Casualty Insurance
   B. Coupon Fraud Control Program
   C. Post Office and Post Roads committee
   D. The Mail Fraud Statute
Review Answers

1. A. Correct. “Everything old is new again” applies to the incidence of schemes and scams taking place in the world of fraud.
   B. Incorrect. Spurious Treasury notes do not apply to the incidence of schemes and scams taking place in the world of fraud. Instead, these notes were often used in counterfeiting fraud.
   C. Incorrect. “Robbing Peter to pay Paul” does not apply to incidence of schemes and scams taking place in the world of fraud. Instead, this is the basic premise of activities such as the Ponzi Scheme.
   D. Incorrect. Bucketing does not apply to the incidence of schemes and scams taking place in the world of fraud. Instead, “bucketing” an order occurs when brokers take victims’ money but never buy the ordered equities.

2. A. Incorrect. An understanding of green cigars is not crucial for an investigator to succeed. Instead, this is a form of counterfeit fraud.
   B. Correct. Vigilance is crucial for an investigator to succeed.
   C. Incorrect. An understanding that, given the opportunity, all fraudsters would succeed in legitimate activities is not crucial for an investigator to succeed. Rather, it is unlikely that fraudsters would exchange criminal behavior for legitimate activities.
   D. Incorrect. Comfort in the art of manipulation is not crucial for an investigator to succeed. Rather, fraudsters’ talent for manipulation encourages them to continue in criminal activity.

3. A. Incorrect. The green goods swindle is not an organized syndicate of con men operating elaborate scams from an every-day storefront. Rather, these con men, known as grifters, set up fraudulent operations that involved fixed gambling and sporting events, for example.
   B. Correct. The green goods swindle was the most common fraud scheme in the late-1800s that promised top-quality counterfeit money at a discount.
   C. Incorrect. The green goods swindle is not a scam in which fraudsters convinced individuals they were heirs to the non-existing fortune of Jacob Baker, a surgeon in the Continental Army during the Revolutionary War. Instead, between 1896 and 1937 fraudsters solicited money through the mail for the purpose of probating the alleged will of Jacob Baker. If the person solicited could be convinced that he or she was a Baker descendant, they were sold a share in the mythical estate.
   D. Incorrect. The green goods swindle was not an investment scam that involved paying initial investors with money from new investors. Rather, this refers to the Ponzi scheme which, essentially, was robbing Peter to pay Paul.

4. A. Correct. The Ponzi scheme claimed the ability to purchase International Postal Reply Coupons from foreign countries and then redeem the coupons in the United States at a substantial profit due to differences in exchange rates.
   B. Incorrect. Grifters did not claim the ability to purchase International Postal Reply Coupons from foreign countries and then redeem the coupons in the United States at a substantial profit due to differences in exchange rates. Instead, these organized con men operated elaborate scams camouflaged as a typical storefront.
   C. Incorrect. Green articles did not claim the ability to purchase International Postal Reply Coupons from foreign countries and then redeem the coupons in the United States at a substantial profit due to differences in exchange rates. Instead, this is one example of a counterfeit money scheme popular in the late-1800s.
   D. Incorrect. The Sir Francis Drake inheritance scam did not claim the ability to purchase International Postal Reply Coupons from foreign countries and then redeem the coupons in the United States at a substantial profit due to differences in exchange rates. Instead, Oscar Hartzell created a scam in which he told victims they were heirs to Sir Francis Drake’s fortune. Victims were asked to invest money for legal work to prove the claim.
5. A. **Correct.** Grifters conducted fraudulent business schemes using a storefront as a base. An organized syndicate of con men, grifters operated elaborate schemes such as fixed gambling and sporting events. Operations became known as the big store, which meant a wide-open town where anything goes.

B. Incorrect. Green cigars did not conduct fraudulent business schemes using a storefront as a base. Instead, under the green swindle scheme, green cigar was one of many terms used to identify articles sold in counterfeit money schemes.

C. Incorrect. Baker heirs’ swindle did not conduct fraudulent business schemes using a storefront as a base. Instead, this was a scheme in which fraudsters told victims they were heirs to the large estate of Jacob Baker, a surgeon in the Continental Army during the Revolutionary War. The estate did not exist.

D. Incorrect. Joseph “Yellow Kid” Weil did not conduct fraudulent business schemes using a storefront as a base. Rather, Joseph Weil was an active fraudster from 1900 through 1940.

6. A. Incorrect. Charles Ponzi was not known for legendary scams such as firing a shotgun loaded with gold pellets into an abandoned quarry then selling stock in the “gold mine.” Instead, Ponzi claimed he could buy International Postal Reply Coupons from foreign countries and then redeem them in the United States at a substantial profit.

B. **Correct.** Joseph “Yellow Kid” Weil was known for legendary scams such as firing a shotgun loaded with gold pellets into an abandoned quarry then selling stock in the “gold mine.”

C. Incorrect. Oscar Hartzell was not known for legendary scams such as firing a shotgun loaded with gold pellets into an abandoned quarry then selling stock in the “gold mine.” Instead, Hartzell was the mastermind behind the Sir Francis Drake inheritance scam that ran from 1924 through 1933. He manufactured a large fortune and told victims they were relatives of Sir Francis Drake and, therefore, entitled to part of the inheritance.

D. Incorrect. Nels Irwin was not known for legendary scams such as firing a shotgun loaded with gold pellets into an abandoned quarry then selling stock in the “gold mine.” Instead, Irwin was one of the most successful work-at-home operators selling a variety of plastic novelties.

7. A. Incorrect. The true nature of fraudsters is not to rob only from the rich. Though many well-known fraudsters such as Ponzi claim to rob from Peter to pay Paul, they are rarely motivated by the desire to give to the poor.

B. Incorrect. The true nature of fraudsters is not the desire to use intelligence and imagination for the greater good of mankind. Rather, they are much more content and driven to succeed in fraudulent activity.

C. **Correct.** The true nature of fraudsters is the desire to steal from anyone who is naïve, trusting and has money.

D. Incorrect. The true nature of fraudsters is not to teach victims not to fall for scams in the future. Rather, they are content to scam victims repeatedly.

8. A. Incorrect. A bucket shop is not the first organized scam to use the railway mail service for fraudulent purposes. Instead, as early as the 1830s swindlers took advantage of new mail routes established across the country for fraudulent purposes.

B. Incorrect. A bucket shop is not an operation that offered counterfeit money printed from stolen Treasury Department plates. Instead, this is an example of a green goods swindle.

C. **Correct.** A bucket shop was an office where individuals gambled in commodities sold on exchanges. Brokers took victims’ money but never bought the ordered equities.

D. Incorrect. A bucket shop is not a storefront for medical scams. Rather, the 1950s saw the spread of medical scams that took victims’ money and, in many cases, affected their health.
9. A. Incorrect. Trans-Continental Casualty Insurance is not the weapon of choice in stopping widespread fraud. Instead, this was considered one of the largest frauds ever prosecuted in the 1970s. The defendants used the financial resources of Trans-Continental, backed by the fraudulent Bank of Sark, for collecting fees for nonexistent loans.

B. Incorrect. The Coupon Fraud Control Program is not the weapon of choice in stopping widespread fraud. Rather, this fake redemption center was established by postal inspectors investigating the scope of fraudulent coupon redemption fraud.

C. Incorrect. The Post Office and Post Roads committee is not the weapon of choice in stopping widespread fraud. Instead, the Post Office and Post Roads committee were responsible for establishing terms and conditions for punishing mail fraud.

D. Correct. The Mail Fraud Statue is the weapon of choice in stopping widespread fraud.
Chapter 3
Use Your Imagination

Learning Objectives

- Recognize an innovative concept for revealing a widespread fraud scheme that provided kickbacks to corporate purchasing agents for buying inflated cleaning supplies
- Spot a valuable asset in gathering information about fraudulent activity

Introduction

Of the many qualities that fraud investigators need, imagination is one of the most important. Fraud investigators, in fact all investigators, need to use their imagination when approaching an investigation. The most successful fraud examiners are creative and continually think outside the box. They come up with unique ideas and approaches to problems that result in the successful resolution of cases. In my career I have found imagination to be a powerful tool that I have employed in investigation after investigation. Imagination was especially helpful in tough cases where the need to obtain evidence of fraud was the most challenging.

The Mob Stings Fraudsters

In 1988, I conducted an investigation of a widespread fraud scheme that provided kickbacks to corporate purchasing agents for buying grossly inflated office cleaning products and computer supplies. I had isolated successes going after individual scam operations, but that did not stop other fraudsters from continuing their criminal enterprises. I decided to target the entire industry using a sting operation to obtain needed evidence. Imagination was the foundation of the operation.

I came up with a unique approach for the sting. The premise of the sting I developed was that organized crime would want to get in on the lucrative fraud racket and want to run a boiler room. The first thing I needed was a way to attract these fraudsters and then catch them in the act. The mob would operate behind the scenes as hidden owners, while using savvy fraudsters to be the public face of the operation and run the scam. Our story was that an underboss of a New York Mafia family was interviewing experienced fraudsters to work the day-to-day operations of the boiler room and they would pay hefty commissions to fraudsters who could sucker victims into parting with their money. This scenario provided both the monetary lure and the mob backing that I felt would attract our targets. All that was needed was the right undercover operative to pose as the Mafioso.

Luckily, I had a confidential informant (CI) from another case who looked and sounded like he had just walked off the set of *The Godfather* or *The Sopranos*. He was willing to work with the government on this undercover operation and he had the confidence and expertise to pull off the sting. I also had confidence in the CI and that was important. His ability to convince the targets that he was indeed a mobster looking for an entry point into fraud was critical to the success of the operation. After a great deal of planning and strategy, the sting was ready to proceed. I put the word out on the street, through my many other informants, and waited to see what would happen. I go into much greater detail on informants and whistleblowers in Chapter 8.

I set up the sting in a hotel on Long Island, New York, using adjoining rooms. The decision to use this particular hotel was based on its convenient location near a highway, and because the design of the rooms allowed for effective electronic surveillance. One room was set up as the interview site with hidden cameras and microphones. The room next door was our base of operation where we could monitor and record the audio and video. It also allowed us the ability to get into the room in case things went bad and
we needed to protect the CI. I had our team stationed in the surveillance room and also in undercover vans outside the hotel.

The bait worked, and the CI started getting calls from a rogues’ gallery of boiler room scammers in and around the New York metropolitan area. If they passed the initial phone screen, and of course they all did, they were invited to the hotel for an in-person interview to meet the underboss. I scheduled interviews several hours apart to allow for enough time for the meetings and so none of the targets would run into one another coming and going from the hotel.

But, things do not always go as expected, and we had a few glitches. My technical people used room lamps to hide the video cameras. The lamps were rectangular glass lights with the cameras inside but in order for the cameras not to be seen through the glass, we had to use smoked glass. The smoked glass blocked the light that we would need for a clear recording, and when we tested the video the images were so dark we could not see anything. Unfortunately, our technical specialists had not tested this earlier, and we were just hours away from our first undercover meeting. We couldn’t get another lamp or build something new. We just didn’t have time.

I came up with another idea. Since we couldn’t replace or retrofit the lamps, why not brighten the existing light in the room? We would just swap out the 60-watt light bulbs in the lamps with higher-wattage ones. I sent one of my investigators to a nearby store with orders to buy 150-watt light bulbs. The higher-wattage light bulbs would throw off more than enough light, and that they did. The room was so bright that our CI had to wear sunglasses to shield his eyes from the light. But this also worked to our advantage as the sunglasses reinforced the look of a Mafioso character.

When the first subject knocked on the hotel room door and entered, the bright light came as a surprise. He wasn’t expecting to walk into Miami Beach at noon when outside it was a dark and cold New York winter day. He quickly covered his eyes and exclaimed, “My god, it’s bright in here.” Our sunglass-wearing CI calmly responded, “It’s fine to me; forget about the light and let’s get down to business,” and they sat down to talk.

The first few days couldn’t have worked out better. The telephone scammers who came to the hotel totally bought into the mobster act. The undercover CI wanted to know how experienced in fraud the people he was going to hire were. They were happy to oblige and impress him with their prowess in scamming people. In the process, the fraudsters implicated themselves and others. They bragged about how they had defrauded victims over the telephone using a variety of phony pitches. They provided their boiler room employment histories, their phone names, and the names and modus operandi of other boiler room operators with whom they had worked. It was December 1988, and things were going great, but television and Mother Nature would conspire against us.

Later in the week there was a snowstorm that paralyzed much of Long Island, and all of the remaining interviews had to be canceled. There was also a television series running at the time named Wiseguy. The premise of the show was that an undercover federal agent named Vinnie Terranova had infiltrated the mob and was running a sting against them. Sound familiar? That show was popular just when we were conducting our sting. The show and its story line were not missed by our fraudsters. They started talking among themselves that the coincidence was too much to ignore. They wondered if it was possible that the mob-run boiler room could be a law enforcement sting just like on Wiseguy. That was the last time that anyone showed up at the hotel room. In fact, we received a call in the room from one of the subjects saying that he was too smart to fall for this “cop trap” and what exactly we could do to ourselves.

Although I had to end the sting earlier than planned, we were still very successful. I had five people on tape admitting to criminal activity and I later flipped them to assist me in the continuing investigation. This resulted in many additional arrests and prosecutions. We put fear into the boiler room community that law enforcement would be relentless in pursuing them using all the appropriate and legal tricks of the trade, including imagination.
Making the Typewriter Talk

Early in my career, I was a confidential investigator for the New York State Department of Agriculture and Markets. I was in charge of internal investigations related to employee misconduct and other violations of agency policy and procedures. One day, a secretary in the legal bureau told me that she witnessed inappropriate conduct by another secretary and wanted to confidentially report it to me. I was told that the subject was doing personal work, as well as a job for an outside business, during business hours. Apparently, the subject was transcribing reports for private law firms unrelated to the state government work for which she was being paid. If true, this was a serious abuse of policy that needed to be investigated.

I began my investigation knowing that I needed positive proof that the employee was doing what had been alleged. I thought about how to obtain the evidence and the approach became evident as I looked at the secretary’s desk. The subject used an IBM Selectric typewriter. In 1976, electric typewriters such as the IBM Selectric were standard issue for secretaries and executive assistants. I realized that the Selectric used carbon film ribbons that had black powder on a clear plastic tape. Carbon ribbons provided a much cleaner and sharper imprint of the character on the paper than the fabric ribbons that were on other typewriter models. I also learned that carbon ribbons were used only once so there wouldn’t be the repeated striking of characters like on inked fabric ribbons. I then knew how I would determine whether the subject was doing unauthorized work while on the job. I would have the typewriter talk to me and provide the evidence.

After everyone had gone for the day, I replaced the secretary’s carbon ribbon with a new one. I was going to read the old ribbon to determine what was on it. Since the carbon ribbon was only used once, each character typed would be readable one after the other. It was a slow and tedious process of reading the letters in order and writing them down to make words, sentences, and paragraphs. Over time, I was able to reconstruct what the secretary had spent part of the day doing. It was just as the informant reported. The subject was not doing official department work but instead was typing transcripts for an outside law firm. She was being paid by this law firm while also receiving her state government pay. The employee was interviewed and when confronted with the evidence, she made an admission. Since this was her first offense, she was disciplined instead of fired.

Where the Law of Gravity Doesn’t Apply

Oddly enough, there is a place where fraudsters believe Isaac Newton’s Law of Gravity doesn’t apply. That place is Queens, New York. Newton pondered why an apple fell to the ground rather than falling up toward the moon, and subsequently developed his Law of Gravity and Three Laws of Motion. Flowing water, like an apple falling from a tree, heads down, not up. Fraudsters in Queens obviously never studied Newton and thought no one else did. As you will learn from this case study, the scammers in this insurance fraud scheme tried to convince an insurance company that water flows uphill.

This investigation is another example of using your imagination as an investigative tool. In the early 1990s, I was investigating a widespread insurance fraud conspiracy. (For more information and another case study on insurance fraud, see Chapter 5.) It was very early in the investigation, and I was trying to obtain cooperating defendants and witnesses. I didn’t have much hard evidence, but I had some very suspicious insurance claim files that I had obtained from several insurance companies. I reviewed these files because the participants were the insurance adjusters I suspected of committing fraud. One file I reviewed caught my attention.

The claim was a residential property claim for water damage that occurred in July 1987. It was a very small claim, only about $12,000. George Cohen and his wife lived on the top floor of an apartment building in Queens, New York. In the insurance claim, the insureds stated that somehow they left the water running in their kitchen sink when they left their apartment. To make matters worse a dish towel had fallen into the sink, blocking the drain. The water flowed, filled up the sink, and began to flood the apartment. It was many hours before the residents returned, and by then the entire apartment had suffered water damage. If you believe the insureds’ story, all the furniture in the apartment was water damaged. All their clothes and other contents were water damaged, even contents in closets and on shelves.
Imagine in your mind the picture here. Supposedly, the water ran for hours and hours, so much so that the entire apartment was filled with water, damaging everything inside. To believe that this claim occurred as the insureds said would require one to suspend the Law of Gravity. For in this case, water flowed up filling the entire apartment. In fact, these insureds wanted their insurance company to believe that rather than living in Queens, New York, they lived in the cartoon world where gravity and physics do not apply. I can almost envision the scene when the apartment dwellers returned to their apartment. The apartment had already filled up with water to the ceiling. When the door was opened, the flood of water gushed out, drenching them and everyone one else on that floor and the floors below.

Oddly enough, the claim was quickly paid in full and the claim file closed. One would think that reviewing the description of the claim would set off red flags of insurance fraud and an investigation would have ensued. Just the opposite occurred; no one saw anything suspicious. No one interviewed the Cohens or asked them any questions. The claim file sat in the insurance company’s archives untouched for almost four years until I found it.

The claim file had all the tell-tale signs of fraud. The circumstances of the water damage claim were suspect. The written narrative in the claim file detailing the damage was extensive and detailed. The entire apartment was allegedly damaged by water but the accompanying Polaroid photographs were few in number and did not show any water damage. There were many unanswered questions that should have been asked and answered at the time the claim was filed, and before a settlement was made.

In my review of the insurance claim file, I couldn’t substantiate the damage from the photographs found in the claim file, but I instinctively knew there was a problem with the claim. The insurance adjuster wrote in his report:

*Kitchen sink overflowed while water left running, and unattended, resulting in damage to contents and improvements and betterments. Insured accepted my allowances as shown subject to actual acquisition of the contents. Risk appears average.*

The pictures of furniture that supposedly had water damage, including a six-piece sectional sofa, a dining room table and four chairs, and bedroom furniture, just didn’t show any damage. There were no pictures of standing water or waterlogged clothes or any other contents of the apartment. My review of the claim file found that although the site of origin of the water damage was the kitchen sink, no damage was reported in the kitchen and nothing in the kitchen was claimed as damaged. There were no pictures of the kitchen, and there were no statements from other people who lived in the apartment building as to any water damage that they may have had as a result of the flood.

Cohen and his wife lived on the sixth floor of the apartment building, and although the water was left running for many hours, supposedly causing damage throughout the apartment, none of the neighbors living below the insureds or to either side reported any damage. Cohen and his wife wanted the insurance company to believe that although water filled the apartment, none escaped next door or to any apartments below. An interesting fact was that Cohen was involved in the property claims industry as the owner of a salvage company that did extensive work with insurance companies including the insurance company he filed his claim with. Even more interesting was that the insurance company adjuster on the claim had worked closely with Cohen for many years.

I decided that this was the perfect insurance claim to investigate further. Another federal agent and I decided to conduct a surprise interview of Cohen and his wife at their apartment and ask them about the insurance claim from 1987. Even though it was now 1992, they had to remember the claim and could hopefully provide some details. When we arrived at their apartment in Queens, we learned from the new occupants of the apartment that the Cohens had moved years earlier to a house on Long Island, New York.

But, rather than thanking the new occupants for the information and leaving, I asked them if we could come in and ask them a few questions. They agreed and invited us in. I asked them if they were ever told that there had been a huge flood in this apartment in 1987. They said they had no knowledge and were surprised to hear that their apartment had such extensive water damage a few years ago.
I then asked if we could pull up their carpeting at one end of the room to see what kind of flooring was underneath? They were a little perplexed, so I explained that I wanted to see if they had wood flooring. I said that if there was wood flooring beneath the carpet, there might be evidence of water damage from the flood. They allowed us to carefully pull up the carpet.

I found unfinished wood floors with no evidence of water damage. I pulled up the carpet from another corner of the room and again found no damage. There were wooden floors throughout the apartment except in the kitchen and bathroom, and there was no evidence of water damage to any of the floors.

I also inspected the walls, especially at the point where the drywall meets the floor. Water damage to drywall can easily be seen, but there was no damage to any of the walls in the apartment. I also checked to see if any drywall had been replaced. When water or other damage occurs, a section of the drywall near the floor is cut away and replaced with new drywall. I checked and saw no seam, new spackle, or other evidence that any walls had been replaced.

There was no evidence of prior water damage in the apartment or of any repairs. I interviewed other tenants next to the subject apartment and on the floors below. I found a number of people who had lived in the building during the alleged water damage claim. No one had any recollection of a flood in the subject apartment, and no one had suffered any water damage in their apartments.

I spoke to the building superintendent, who had worked there for many years including at the time of the alleged flood. He remembered the prior occupants of the subject apartment but was unaware of any water damage claim. He said he would have known about any damages in the building because it would be virtually impossible for that type of damage to occur without his knowledge. He also said that if the alleged water damage claim occurred, the water would have spilled into apartments below the subject apartment and the tenants would have complained to him, which they did not.

The superintendent further stated that if that amount of water damage had occurred, work would have had to be done in the apartment, including carpet cleaning and/or replacement, furniture repair and restoration, repair of the drywall and wooden floors, and painting. He did not perform any of those repairs in the apartment and he would have been aware if any work had ever been done.

To be even more thorough in building my criminal case, I spoke to the office manager for the apartment building. She had worked in the building for 13 years and was unaware of any water damage claim filed by the Cohens. She also said that any claim would have been included in their tenant file, but there was nothing found. I also examined all the other tenants’ files for water damage related claims but found nothing as well.

I next contacted the insurance broker for the Cohens. The claims representative for the insurance broker advised that she provided the insurance policy for the Cohen’s apartment. She said that she had been in the insurance business for 40 years and that this water damage claim was suspicious to her because it was not reported to the insurance broker when it occurred. The claims representative said that in almost every case that she can remember, the insured would report the claim to his or her broker. But in this claim, the Cohens reported the claim directly to the insurance company. In fact, the broker first learned of the claim when she received a copy of the payment draft paid to George Cohen by the insurance company.

The evidence I had obtained indicated that no water damage had ever occurred and Cohen had submitted a fraudulent insurance claim. To fully prove it was fraudulent, I needed to obtain the furniture Cohen claimed had been damaged. I believed that when the Cohens moved from their apartment to their new home, they took the furniture. If the furniture was still in their possession, I would determine if the furniture was ever damaged by water or had been repaired due to water damage.

The Postal Inspection Service Crime Lab informed me that a scientific examination of furniture can determine whether or not it has been reupholstered, stained, or damaged by water and repaired. If I found the furniture in the house, I could send it to the crime lab for this examination.

I obtained a search warrant to seize the furniture from the Cohen’s home. I met with the Assistant United States Attorney on the case and explained the basis for my search warrant request and the evidence already obtained. I contended that in my experience investigating insurance fraud, insureds often retained property that they falsely claimed as damaged or destroyed, particularly big ticket items such as
furniture and appliances. The federal prosecutor agreed with my argument and we prepared a search warrant.

My search warrant requested seizure of the items originally claimed as damaged, including a sofa, a dining room table and four chairs, a dresser, a matching chest of drawers, and two end tables. I included in the search warrant language that limited the intrusiveness of the search to areas which might contain such large pieces of furniture. The federal magistrate to whom I presented the search warrant request agreed and authorized us to enter and search the Cohen home.

You can imagine the surprise of the Cohens when federal agents showed up at their front door early one morning with a search warrant in hand and a moving truck at the curb. We searched the house, and lo and behold, we found several pieces of the furniture inside. We found one of the dining room table chairs and the two end tables. We seized the furniture as evidence and sent it to our crime lab for examination.

My request to the crime lab was to examine the furniture for any evidence of water damage to the wood or the upholstery, as well as any repairs that may have been made resulting from water damage. The crime lab found no evidence of any water damage to the wood furniture or refinishing of the wood. The Cohens could have argued that they kept the water damaged furniture and had it repaired, and I wanted to be able to eliminate that possible defense.

Finding the upholstered dining room chair was especially important. When cloth upholstery is attached to the wood frame of a chair, upholstery tacks or staples are used to keep the fabric in place. Unless the fabric has been replaced, such as in the case of water damage to the fabric, there should only be the original tack or staple holes in the wood frame. When the crime lab examined the chair taken from the Cohen home, they found that the upholstery had never been changed, as there was only the original set of tack holes and no replacement tacks. They also tested the fabric and found no evidence of water staining or damage.

Using the substantial amount of evidence developed, we subsequently indicted and arrested George Cohen for violation of the Mail Fraud Statute. The evidence against Cohen was so overwhelming that he agreed to plead guilty and cooperate against other insurance fraudsters. His cooperation and that of others helped in the subsequent prosecutions of other fraudulent insurance claims and the defendants involved in those claims. The corrupt insurance adjuster was arrested, convicted, and sentenced to prison. Of particular note, Cohen’s father, who was co-owner of the salvage company, also agreed to plead guilty and cooperate, in the hope that his cooperation would help his son.*

Welfare for the Deceased

An early use of computers to detect fraud helped disclose a widespread welfare fraud case in San Francisco in 1978. At the time, I was an investigator with the San Francisco District Attorney’s Office, and we often used computers to search the payroll records of city, postal, and federal employees living in San Francisco to determine whether they were receiving welfare while working in government jobs. In addition, we used the Social Security Administration’s Death Master File to discover whether there were any welfare payments being issued after the death of the recipients. The Social Security Administration created the Death Master File to assist financial institutions and businesses in making sure that customers or job applicants were not using the Social Security number of a deceased person.

An initial computer check in October 1977 found 323 potential cases of welfare fraud that resulted in criminal charges against 69 people. San Francisco welfare payments were being made in the names of dead people and ineligible recipients who were on the public payroll. We also found that the San Francisco Homemaker Chore Services Program was being used by fraudsters. The program provided assistance to elderly, blind, or otherwise disabled residents who were unable to shop, cook, or clean their homes for themselves. Payments were made in the names of people who did not need the homemaker chore services as they were either living in nursing homes, in hospitals, or were dead.

* The names of the individuals mentioned in this case study have been changed.
Chapter 3 – Use Your Imagination

We eventually went through two million documents in four additional computer runs. On August 31, 1978, the San Francisco District Attorney’s Office announced new charges and the indictment of 20 persons on charges of conspiracy, embezzlement, misappropriation of public funds, and grand theft.

The Value of Imagination

Remember to always use your imagination in the detection, investigation, and prevention of fraud and other crimes. Tough cases call for smart decisions and strategy to get to the truth. Use creative thinking throughout the investigation to learn the facts. Take the facts and knowledge that you have and develop new ideas and investigative techniques. I never knew anyone who obtained a search warrant to seize furniture, but that didn’t stop me from doing just that. As a result, I was successful in my investigation.

As you conduct your fraud examinations, remember this quote from Albert Einstein. “Imagination is more important than knowledge. Knowledge is limited. Imagination encircles the world.”

Other examples of investigative imagination can be found in Chapters 5 and 10, as well as throughout this book.
Review Questions

1. What creative strategy was used to prove an insurance claim for water damage was fraudulent?
   A. Obtaining a search warrant for the furniture
   B. Running a background check on all city residents
   C. Checking the Death Master File
   D. Checking the Social Security Index

2. Which of the following helped disclose a widespread welfare fraud case?
   A. Computers
   B. Search warrant
   C. CI
   D. Insurance claims
Review Answers

1. A. Correct. Obtaining a search warrant for the furniture was a creative strategy used to prove an insurance claim for water damage was fraudulent.
   B. Incorrect. Running a background check on all city residents was not a creative strategy used to prove an insurance claim for water damage was fraudulent. Instead, running background checks is one benefit of computer programs available to investigators.
   C. Incorrect. Checking the Death Master File is not the creative strategy used to prove an insurance claim for water damage was fraudulent. Instead, checking this Master File is effective for revealing welfare fraud.
   D. Incorrect. Checking the Social Security Index is not the creative strategy used to prove an insurance claim for water damage was fraudulent. Instead, checking the SSI provides valuable information in determining whether fraudsters are using a different identity to commit crime.

2. A. Correct. An early use of computers helped disclose a widespread welfare fraud case.
   B. Incorrect. A search warrant did not help disclose a widespread welfare fraud case. Rather, search warrants provide investigators the opportunity to gather information that is not readily available.
   C. Incorrect. A CI did not help disclose a widespread welfare fraud case. Instead, CIs assist investigators in detecting fraud in a variety of scenarios, including, meeting with a suspected fraudster to gather information.
   D. Incorrect. Insurance claims did not help disclose a widespread welfare fraud case. Instead, reviewing insurance claims is one way to determine whether insurance fraud has occurred.
Learning Objectives

- Identify a valuable investigative tool that can assist an investigator in finding evidence
- Ascertain what is essential in gathering information from fraudsters
- Determine one way an investigator can make his own luck

Introduction

There is a saying that it is better to be lucky than good. But, I argue that it is even better to be lucky and good, and you can accomplish that with hard work and experience. Know your profession inside and out, and be a subject matter expert and thought leader in fraud detection, investigation, and prevention. Always be prepared and go the extra mile in all your work. Filmmaker Woody Allen once said that 80 percent of success is showing up. I do not believe that just showing up is quite enough to ensure success, but being present is incredibly important. What is meant by that quote, and its application to fraud investigations, is the importance of being in the right place at the right time.

Throughout my career, I always seemed to be in the right place at the right time. In one example, I walked into a homicide that had just occurred, but I didn’t actually see it happen. I had just left the United States Attorney’s Office in Brooklyn, New York, after a grand jury proceeding and was walking to my car. I saw a dead body behind my car and the shooter standing over the body. Although the shooter initially claimed self-defense, saying that the deceased had pulled a knife on him and another person, I quickly realized based on the evidence before me that he was lying. I took his gun, secured the crime scene, found the person who the deceased was supposedly threatening, found several witnesses who said the shooting was a cold-blooded killing, and turned the information over to the New York City police officers who responded to the scene. I testified in the grand jury and at trial, and the defendant was subsequently convicted of the murder.

I have many more examples showing how I have made my own luck. By this I mean I prepared myself to the best of my ability, to be successful in the cases I was working on. You can do this as well by being well-trained and continuing that training and education throughout your career. Consider using a three-pronged approach to learning—learn from your work and experiences on the job on a daily basis; learn from the subject matter expertise of your coworkers; and learn from formal classroom training and conferences such as the excellent training conducted by the Association of Certified Fraud Examiners. Make your work your passion and use the mistakes of fraudsters to your advantage.

Fraudster Stupidity Is Your Friend

Fraudster stupidity can make an investigator lucky. There are plenty of stupid fraudsters. We just wish all fraudsters were stupid, because that would make catching them so much easier. In July 2012, police investigators in Southern California were investigating a medical doctor for illegally prescribing narcotic painkillers to drug addicts and others. The doctor was alleged to be running a pill mill where painkillers were provided to patients without a legitimate medical need. As part of the investigation, undercover officers posed as patients and requested painkillers from the doctor. One officer showed the doctor an X-ray to prove he needed the painkillers. The X-ray was of the officer’s German shepherd, clearly showing the dog’s tail. We will never know whether the doctor knew the X-ray was that of a dog or not, but it was enough for the doctor to prescribe the narcotics.¹

In another instance, an executive at the pharmaceutical giant Bristol-Myers Squibb was arrested on August 2, 2012, and charged with insider trading for using confidential company information regarding possible pharmaceutical company acquisitions. The executive used a number of personal brokerage accounts to illegally trade stock options of companies being considered for acquisition. As detailed in the SEC press release, the executive was tripped up by using his Bristol-Myers Squibb computer, which was connected to the company network, to conduct online research to determine whether his insider trading activity could be detected by the SEC. If that wasn’t enough, he searched for such phrases as *can stock option be traced to purchaser* and *illegal insider trading options trace* and viewed an article titled “Ways to Avoid Insider Trading.” The executive even viewed a press release on the SEC’s website announcing an enforcement action arising from illegal trading in call options in advance of an acquisition announcement.2

**One Man’s Trash Is an Investigator’s Gold**

In 2001, I conducted a bank fraud investigation on behalf of a major international financial institution that had provided a large line of credit to two food service businesses in the United States. The investigation found the subject businesses were involved in a massive scheme to defraud the victim’s financial institution by utilizing fictitious sales to related parties in which the entities maintained a hidden interest. The subjects utilized fraudulent invoices generated on an electronic accounting system to create an entirely bogus set of financial records in the furtherance of their scheme to defraud the bank and conceal their crime from the bank’s auditors. The investigation involved a review of the accounting practices and financial dealings of the subjects, a review of bank statements, cancelled checks and other financial records, in-depth background investigations, interviews, and other investigative techniques. The loss to the financial institution was found to be in excess of $50 million.

There was a major break in the case when I discovered torn-up bank documents in the trash of one of the subject businesses. An accounting department employee had been instructed by the subjects to destroy any evidence of the diversion of funds. Thinking that no one would look in the garbage, the employee simply tore the documents in half and threw them into the garbage can outside the building. It is amazing the amount of evidence that fraudsters will unwittingly discard. I have made numerous cases over the years by going through the garbage of subjects. Dumpster diving, when and where legally allowed, is a valuable investigative tool and best practice that should be considered where applicable.

After being provided with the findings of my investigation, the client requested that the case be referred for criminal prosecution. I recommended that the case be referred to the United States Attorney’s Office in Los Angeles since it had jurisdiction over bank frauds in that area. I also informed the client that I had a close relationship with that prosecutor’s office, as I had previously worked as a federal supervising a fraud team in Los Angeles. I was able to quickly schedule a meeting with a supervisory Assistant United States Attorney who agreed to accept the case for prosecution and assigned the FBI to the criminal investigation.

My investigation also found that the financial institution had failed to conduct adequate due diligence on the subject businesses prior to providing the lines of credit. This information was provided to the client for appropriate action on their part. Failure to conduct appropriate due diligence is a big risk for organizations especially with mergers and acquisitions and other business dealings with third parties.

**Let Them Talk**

When you come across a fraudster who is willing to speak to you and not invoke their Fifth Amendment rights against self-incrimination, always let them talk. To paraphrase the late radio and television personality Art Linkletter, “Fraudsters say the darndest things.” The criminal ego often makes scammers think

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they are smarter than their pursuers, and rather than stay silent, they will try to con the interviewer. They often will make statements that can be useful, either the more common false exculpatory statements or the sometimes rarer admissions, especially if you allow them to speak. A false exculpatory statement may be one where the fraudster denies ever speaking to the victim when you have him on an incriminating taped conversation with the victim. The important thing is to let them speak. Do not break the flow of the conversation by constantly interrupting the fraudster.

A bank investigator I was working with on a credit card fraud case came into my office one day to tell me of his encounter with the targets of the investigation. I was initially surprised that he had approached the subjects but when he told me the details of his interaction, I was even more dismayed. He had uncovered some documentary evidence of the subjects’ fraudulent activity. Rather than come directly to me to share the important findings, he decided to take matters into his own hands.

He told me how he proudly blew into their office and confronted them with the evidence, yelling at them that he had the “goods on them” and would “shortly return to arrest them.” I asked the investigator what the subjects said in response. Amazingly, he said they didn’t say anything because he was too busy yelling at them and then he left their office. I was shocked, as this bank investigator had spent his prior career in law enforcement and should have known better. He was so swollen with pride over confronting the fraudsters that he was blind to what he had done. Unfortunately, I brought him back to earth by telling him the only thing he did was to hinder our case with his behavior. We were still able to successfully prosecute the case from the documentary evidence we obtained through subpoenas, but it would have been easier if we had statements from the defendants.

**Arson for Profit Case: Impeaching the Defense Expert**

I investigated an arson-for-profit case that had a unique twist. Besides the usual facts surrounding the defendant and the arson of his business for insurance proceeds, there was an unusual opportunity to impeach the testimony of a defense witness who had background baggage. The witness was a consultant in the causation of fires and arson investigations.

There are several lessons to be learned from this case. Always remember that just because a witness claims to be an expert in some field and presents a detailed résumé and supporting documents, there may also be critical information that the expert does not provide for one reason or another. This undisclosed information may prove very valuable once discovered, and remembering this helps to make you lucky in your work.

The defendant in this case was in the movie videotape rental business, and he had decided to open a new store in Queens, New York. He applied for an insurance policy in November 1988 that covered the store and its contents. In March 1989, he set a fire at the store for the purposes of insurance fraud. He then submitted an inflated claim to his insurance company for $1.5 million. He provided phony invoices from the nonexistent business to support his claim. In the course of trying to collect the money, the fraudster sent or caused the sending of five separate letters through the U.S. mail, and that was the basis of the five counts of mail fraud used to prosecute him in federal district court in Brooklyn, New York. The fraudster devised a scheme to defraud his insurance company of money using the U.S. mail in furtherance of that scheme, and as a result became the focus of a federal investigation.

The suspect was arrested in November 1991 and was offered a plea deal but he rejected it, claiming his innocence. He was indicted in December 1991, and the trial took place in October 1992. The evidence presented by the government was very strong. Witnesses included the insurance company investigator, the fireman who supervised the extinguishing of the fire and the subsequent investigation, an independent adjuster, a chemist, an accountant, and others. I testified as the case agent. The documentary evidence was also strong and supported the insurance fraud allegation.

As part of the defendant’s defense, he brought in a fire consultant as an expert witness in an effort to discredit the government’s evidence that the fire was intentionally set by the defendant. The fire consultant was previously employed by the New York Fire Department in a prominent leadership role and had been a fire marshal. Prior to the expert’s testimony, the defense turned over books and pamphlets written
by the expert. This was on a Friday afternoon, and we recessed for the weekend with testimony resuming the next week.

I reviewed the materials the defense attorney provided for the expert, and I immediately felt that something was missing. I believed that a book the expert had written was not provided. I told this to the federal prosecutor and she looked at me stunned. How did I know this? I responded that I try to read as much material as possible to be knowledgeable about the investigation field. In the course of my readings over the years, I thought that I had come across a book that this expert had written that was not among the books provided by the defense.

It kept nagging at me that something might be missing. If true, why was the book not provided to us? I was certain that I was right and spent the weekend scouring the public libraries on Long Island looking for the book. This was before the Internet, and I had to manually search the area libraries. Late Saturday afternoon, I hit pay dirt at the Levittown, New York library. I found the book. It was an autobiography of the expert’s life as a fireman and fire marshal. The book was about true cases from his career. I quickly started reading the book. I wasn’t further than the first few pages when I saw why he did not turn over the book. He admitted that he had lied (his words) on his application to become a fire marshal.

There was even more that I learned as I read the book. The expert wrote about how his training officer had a reputation for threatening and slapping suspects around, calling them animals, and doing anything for a confession and an arrest. He wrote that he had witnessed his training officer batter a suspect about the head. I immediately checked the book out and went home to read the rest. I called the prosecutor and told her what I had found.

When the trial resumed the following week the defense called this expert. He claimed that the fire was not an arson based on his review of the file, but he never even went to the scene of the fire. He said that it could not be arson because in all his years of experience, he had never seen an arson committed during the day. All the arsons he ever investigated occurred in the late evening or early morning.

The prosecutor then asked for a voir dire of the expert (a competency examination of a witness prior to his or her testimony). He was questioned about the missing book, which he claimed was a novel. He was asked to read to the jury the section in which he described how he lied on his fire marshal application. The prosecutor then read the section of the book where the training officer hit a suspect. While the witness claimed that these were the actions of another and he didn’t do them, the point was made to the jury. We successfully impeached his testimony. His claims that the fire was not arson went unheeded by the jury that convicted the defendant on all counts. The defendant was subsequently sentenced to 51 months in prison.

This is a good example of why investigators always need to be prepared, especially at trial. You can make your own luck by being a subject matter expert and thought leader in fraud investigations.

**One Federal Agent’s Attention to Detail**

I spent several years in the 1980s focused on investigations of identity theft, credit card fraud, and the Nigerian Criminal Enterprise groups involved in these frauds. In one case, I obtained evidence that a gang in Brooklyn, New York, had infiltrated businesses as security guards and cleaning crews to steal personally identifiable information such as dates of birth, Social Security numbers, and employment histories. This stolen data were then used to complete and submit fraudulent credit card applications to major financial institutions and credit card issuers. We obtained arrest warrants for two of the ring leaders and search warrants for eight apartments in Brooklyn that the gang was using to receive credit cards. When our teams hit the locations, we found a treasure trove of evidence.

At one of the locations, a very experienced postal inspector who was searching the apartment came across a notebook. It was a typical college notebook, spiral-bound with three-hole punched lined paper and the name Borough of Manhattan Community College on the cover. This postal inspector was one of the best, and he decided to go through the notebook. He went page by page and found notes from physics and chemistry classes, the types of notes one would typically find in a college notebook. He could have
easily stopped his review, put down the notebook, and continued looking elsewhere. But he continued to
go through the pages. That he didn’t stop searching is a testament to his expertise and thoroughness.

The investigator continued to go through the notebook until he got to the middle and he noticed some-thing other than college class notes. He found page after page of lists of names and associated dates of
birth, Social Security numbers, home addresses, employment histories, and credit card numbers. As he
went through the pages, he started to recognize some of the people listed. They included names such as
Walter Cronkite, the famed CBS News anchor and Ed Bradley, the 60 Minutes broadcaster. We had hit the
mother lode, and the attention to detail of this exceptional postal inspector made the case. The discovery
of this evidence was radioed to the other search locations where investigators found similar lists of stolen
personal information.

As we soon came to learn, the hundreds of names and personal information we had discovered came
from CBS News in New York, where the Nigerian fraudsters had infiltrated the company as contract
workers. These scammers had the run of the building’s offices in the late hours after everyone had gone
home. Working as security guards and cleaning people, they were able to go from office to office, riffling
desks and files to obtain stolen personal information on many hundreds of victims. The fraudsters found
unlocked desks and personnel files and meticulously documented the stolen information for later use in
identity theft and credit card fraud.

Finding this valuable evidence at the search warrant site was critical to the ongoing investigation and
prosecutions. The investigator could easily have stopped his review of the notebook after finding co llege
course notes on the first few pages. But he didn’t stop; he made himself and our team lucky and good by
being diligent and thorough in his work.

Look and You Shall Find

Search warrants are one of the best investigative tools available for government investigators. I have used
search warrants whenever possible to obtain evidence that I would not have been able to come by in other
ways.

I was conducting a search warrant at the office of a public adjuster under investigation for fraudulen-tly
inflating the value of insurance claims he was submitting to insurance companies on behalf of the in-
sured he was representing. Since I was the case agent, I made it a point to search the office of the public
adjuster, because it is always a best practice for the case agent to search areas where key evidence may be
stored or hidden. No one knows the case and potential evidence as well as the person who is most familiar
with the investigation from the beginning. It also pays to be thorough, with an inquisitive mind, whenever
conducting a search warrant because one never knows what may be found and where.

The subject’s desk was wood and clearly quite old and well-worn. It had three large drawers on each
side and a long drawer in the middle. I searched the contents on the top of the desk and then each drawer,
carefully looking for items detailed in the search warrants. I noticed something odd about one of the
drawers. While the other drawers reached the same length when pulled out, one came out to a much
shorter distance. I removed this drawer from the desk and examined it.

I noticed that the drawer was much shorter because the rear had been cut and shortened. I looked into
the drawer cavity and reached in until I came to the back of the desk. I found the reason for the shortened
drawer. There was a false back that I was able to push in and remove, and inside this secret cavity were a
number of photographs that the subject did not want anyone to find.

The photographs were of a woman in her early twenties in various suggestive poses and states of undress. The woman was clearly not the subject’s wife. As we learned later, this woman was a personal
acquaintance who was in a relationship with the subject. These were things that the subject wanted to
keep for personal memories but definitely could not have at home where his wife and others might find
them. The hidden location in his office desk was the perfect and safe spot. Or so he thought.

The concealed photographs were not listed on the search warrant so I could not seize them because
they were not germane to the investigation. I left them in his drawer and did not discuss their existence

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with him when we arrested him. Unknowingly, not mentioning the photographs had an unexpected but beneficial effect.

Immediately after arresting the fraudster, he agreed to plead guilty for his insurance fraud involvement and cooperate with my ongoing investigation. His main reason for cooperating was that I had found his secret stash of photos and he did not want his wife and family to learn of his extracurricular activities. I promised that this information would be kept confidential, and it was.

Don’t Take No for an Answer

In 2001, I conducted an insurance investigation on behalf of a major insurance company related to a questionable claim filed by an insured. The insured was a manufacturing company based in the United States with plants overseas. The insured filed a series of insurance claims alleging employee thefts of materials at its plant in Europe that totaled in excess of $7 million. The central issue involved coverage and whether these dishonest employee acts were random, independent acts or were part of an orchestrated conspiracy. If the thefts were unrelated random acts, the insurance company would be liable for the full $7 million, but if I could prove that an employee conspiracy was the cause, the maximum claim would be approximately $1 million.

My investigation included a review of the proofs of loss and supporting documents, analyses designed to determine the extent and amount of the loss, and other investigative tasks. I also hired a local investigative consultant in Europe who had knowledge of local laws and customs to assist me with the case, provide translation services, and liaison with law enforcement authorities currently investigating the matter.

The in-country consultant made some progress, but he was unable to fully determine whether the losses were the result of individual thefts or an organized ring. He did learn that a local prosecutor was investigating the criminal activity, so I asked that he consider approaching the prosecutor to see if he would be willing to share some information with us. The consultant assured me in no uncertain terms that there was no way the prosecutor would ever speak to him, let alone someone from outside the country. Remembering that if you don’t ask, you’ll never know what might happen, I decided to take matters into my own hands. I also believed in my skills and abilities—including my imagination—to get to the truth.

I traveled to Europe to conduct the investigation personally, and ultimately concluded that the thefts were part of a conspiracy involving a number of employees and other outside individuals who fenced the stolen materials. Guess how I learned this? I would not take no for an answer. Over the objections of my local consultant, I asked that he take me to the prosecutor’s office. When we arrived, I asked to speak to the prosecutor and was referred to his assistant. I identified myself and my role and explained that I was a retired federal agent from the United States and would never do anything to jeopardize a criminal investigation.

My client had given me permission to share my entire investigative file with the prosecutor and I relayed this to his assistant; but I was still told that he would not meet with us. I said that I understood but would be willing to wait in case he changed his mind—so we sat in the waiting room just in case. And our patience paid off when after several hours, we were ushered into the prosecutor’s office. He had decided to listen to what I had to say and offer, and if he was convinced of my sincerity, he would speak to us. I repeated what I had told his assistant earlier. My determination paid off and he agreed to share his investigative file with me. The prosecutor had evidence that a group of employees at the insured’s company were involved in a conspiracy to commit the numerous thefts.

As a result of being proactive, I uncovered information not previously provided to the insurance company, and that greatly furthered the investigation. I confronted the insured who admitted that he believed that the thefts were part of an organized ring. Subsequently, the insurance company negotiated a much smaller settlement with the insured than the original claim amount. My investigation saved the insurance company millions of dollars and resulted in subsequent investigative engagements from this client.
If You Don’t Ask, You Will Never Know

Every fraud investigator needs to always remember to ask as many questions as possible. If you do not ask the question, you will never know the answer. You will be surprised what a fraudster or witness may say in response to your questions. With training, experience, and knowledge of the case you are investigating, you will come up with question after question to ask to further your fraud examination. You may even come across circumstances where one question will open the door to even more significant evidence. That is what happened for me one night in Brooklyn, New York.

I was investigating a series of staged insurance claims at residences and businesses in the New York metropolitan area. During my review of a large number of insurance claims, I found some red flags of insurance fraud. In one particular residential claim, the file noted severe water damage throughout the home due to a broken pipe in an upstairs bathroom. The photographs in the file clearly showed water damage to the walls, ceilings, and the contents of the house. There was even a picture of the broken water pipe that caused the flooding in the house. Yet, there was something wrong with the photographs.

Even though there was significant water damage throughout the home, the pictures seemed staged. I had a great amount of experience investigating staged and inflated insurance fraud and the pictures were reminiscent of numerous other fraudulent claims I had investigated. (Other examples of insurance fraud cases and red flags are found in Chapter 5.) The public adjuster representing the homeowners and the general adjuster representing the insurance company in this claim were on our list of suspects. All of these red flags made it a good reason to interview the insureds at their home.

I was working on this investigation with an FBI special agent, and we decided to do a surprise interview of the homeowners. I have found that just showing up unexpectedly at the residence of people I considered subjects, and wanted to interview, is best. I would usually arrive in the early evening when most people are home. While some investigators go out during the workday to conduct their interviews, I have usually found that tactic to be a waste of time. Most people work during the day, and many households have both spouses working, so arriving at midday will often find no one at home.

We arrived at the residence in Brooklyn around 8 p.m. We knocked on the door and introduced ourselves as federal agents. The homeowner identified himself as someone other than the person we were looking to interview. He explained that he had recently purchased the home and he and his family were now the occupants. It may have been pure instinct, but something compelled me to ask what would turn out to be a very important question: “When you bought the house from him, did you purchase any of the contents?” Asking that one question opened the door, both literally and figuratively.

The homeowner responded that indeed he had bought a lot of furniture and home electronics from the prior owner. I had a list of the furniture supposedly damaged by the water and asked about those pieces specifically. The homeowner said that he had purchased those very items, so I asked him if we could come in and look at the items he purchased and ask some more questions. He invited us in, but before we entered, I asked the FBI agent with me to go to our car and get the camera and video recorder.

As we walked through the house, we found item after item that the new homeowner had purchased from the prior owner. The items included a sofa, chairs, coffee table, end tables, and televisions. Each of the items was in perfect shape with no evidence of any water damage. The televisions were in working order and had been since they were purchased. The homeowner told us that he was never told that there was any water damage in the home, and he was also never told that any of the items he purchased had ever been damaged by water or any other means. Yet, according to the prior homeowner when he submitted the insurance claim, these items had been damaged beyond repair.

We photographed and videotaped the allegedly damaged furniture and took a statement from the very cooperative homeowner. I asked him if he knew where the prior owner had moved. He said that he did, and told us that the person and his family had moved just a few blocks away to a larger home. He provided the new address, and we immediately went to the new home of the insured.

We found the subject at home and we introduced ourselves. He was happy to talk to us about the insurance claim at his previous home. He described how all the furniture and other contents detailed in the insurance claim were damaged beyond repair and had to be thrown out. He made numerous false exculpa-
tory statements about the insurance claim and the damaged items that we knew were lies. Imagine his surprise when we told him that we were just at his former home, had interviewed the new homeowner, and had viewed and photographed all the items he just said were dumped due to water damage.

At that point the subject stopped talking and said he wanted to speak with an attorney. We left and told him that we hoped to hear from his attorney as soon as possible, as he had big problems. Within a few days we heard from his attorney who agreed to have him cooperate with us to get the bigger fish in this case. The bigger fish were the insurance company and the public adjusters who orchestrated these frauds.

I don’t know what compelled me to ask that one question, but I did, and it made all the difference. Maybe it was my many years of training and experience, but whatever it was, it made me lucky in my fraud examination. Make yourself lucky whenever you can.
Review Questions

1. Which of the following is an example of fraudster stupidity that assists in revealing their fraudulent activity?
   A. Using Internet search engines to gather information about a relevant topic
   B. Invoking their Fifth Amendment rights against self-incrimination
   C. Claiming to be an expert witness
   D. Saving documents at his or her home

2. What is a valuable investigative tool that should always be used where legally allowed?
   A. Dumpster diving
   B. Constantly interrupting the fraudster during an interview
   C. Confronting suspects with real evidence and informing them of their impending arrest
   D. Trusting a defense witness without fail

3. What is a proactive strategy that assists investigators in making their own luck in a fraud investigation?
   A. Insisting fraudsters invoke their Fifth Amendment rights against self-incrimination before they are interviewed
   B. Choosing witnesses who are experts in a given subject or field
   C. Becoming a subject matter expert and thought leader
   D. Recognizing when to accept “no” for an answer

4. What is the most effective investigative tool available for government investigators?
   A. Fraudster stupidity
   B. Work and experience on the job
   C. Search warrant
   D. Formal classroom training
Review Answers

1. A. Correct. Using Internet search engines to gather information about a relevant topic is an example of fraudster stupidity that assists in revealing their fraudulent activity. Reviewing the suspect’s Internet history could assist investigators in gathering evidence.
   B. Incorrect. Invoking their Fifth Amendment rights against self-incrimination is not an example of fraudster stupidity that assists in revealing their fraudulent activity. Invoking their Fifth Amendment rights against self-incrimination protects them from providing damaging information.
   C. Incorrect. Claiming to be an expert witness is not an example of fraudster stupidity that assists in revealing their fraudulent activity. However, scrutinizing his or her records may reveal evidence of fraud.
   D. Incorrect. Saving documents at his or her home is not an example of fraudster stupidity that assists in revealing their fraudulent activity. Instead, throwing documents in the trash where investigators can find them is more damaging.

2. A. Correct. Dumpster diving is a valuable investigative tool that should always be used where legally allowed. Fraudsters often discard evidence in dumpsters.
   B. Incorrect. Constantly interrupting the fraudster during an interview is not a valuable investigative tool that should always be used where legally allowed. Instead, the important thing is to let the fraudster speak to gather as much information as possible.
   C. Incorrect. Confronting suspects with real evidence and informing them of their impending arrest is not a valuable investigative tool that should always be used where legally allowed. Conversely, this type of behavior eliminates the potential for gathering a statement from the suspects.
   D. Incorrect. Trusting a defense witness without fail is not a valuable investigative tool that should always be used where legally allowed. Rather, just because a witness claims to be an expert in some field doesn’t mean he or she is on the level. Always look for undisclosed information that may damage the investigation.

3. A. Incorrect. Insisting fraudsters invoke their Fifth Amendment rights against self-incrimination before they are interviewed is not a proactive strategy that assists investigators in making their own luck in a fraud investigation. Conversely, the ideal scenario is to interview fraudsters who are willing to speak with investigators without invoking their Fifth Amendment rights.
   B. Incorrect. Choosing witnesses who are experts in a given subject or field is not a proactive strategy that assists investigators in making their own luck in a fraud investigation. Rather, though a witness claims to be an expert, research his or her credentials beyond a resume to check for undisclosed information.
   C. Correct. Becoming a subject matter expert and thought leader is a proactive strategy that assists investigators in making their own luck in a fraud investigation.
   D. Incorrect. Recognizing when to accept “no” for an answer is not a proactive strategy that assists investigators in making their own luck in a fraud investigation. Instead, investigators should trust their instinct, use imagination and never take “no” for an answer.

4. A. Incorrect. Fraudster stupidity is not the most effective investigative tool available for government investigators. However, fraudster stupidity does assist investigators in their conviction.
   B. Incorrect. On-the-job experience is not the most effective investigative tool available for government investigators. Rather, hands-on experience is an excellent learning tool that can assist in solving future cases.
C. **Correct.** A search warrant is the most effective investigative tool available for government investigators. They provide opportunities to obtain evidence that would otherwise not be found.

D. **Incorrect.** Formal classroom training is not the most effective investigative tool available for government investigators. Rather, formal training, paired with on-the-job experience and examples set by co-workers provide a well-rounded learning experience.
Chapter 5
Patience Is a Virtue

Learning Objectives
- Discern what can significantly improve investigative results
- Recognize an internal control that can assist in preventing property insurance fraud
- Determine what is absolutely critical in fostering a climate of honesty and integrity in every organization

Introduction
Patience is an important virtue for fraud investigators. Fraud is often hard to uncover and can lie hidden for months or years before being discovered. During that time, fraud is like an infection eating away undetected until the pain is finally felt, but even then the financial and emotional impact continues. The Association of Certified Fraud Examiners’ 2012 Report to the Nations on Occupational Fraud and Abuse found that frauds lasted a median of 18 months before being detected. The Report to the Nations also found that fraud is more likely to be detected by a tip than any other method. While it is evident that detecting and stopping fraud as early as possible is best, it is not always the case. A fraud scheme I investigated, beginning in 1979, reinforces the importance of patience and the value of tips.

Stopping a Fraud Scheme
In the spring of 1979, I was assigned to the Westbury, New York, office of the Postal Inspection Service. I was given a miscellaneous territory assignment, responsible for postal and mail-related criminal investigations on Long Island, New York. A miscellaneous territory assignment gave me exposure to a wide variety of federal criminal violations including mail fraud, mail theft, embezzlement, robberies, burglaries, assaults, and forgery of Postal Money Orders. This last violation would be the basis for a very unique investigation I would soon conduct.

One day our administrative assistant gave me a letter that she received in the office mail that morning. She told me that these anonymous letters had been coming to the office for the last year, but nothing was being done with them. As I was the new guy in the office, she logically decided that I should be the recipient since no one else wanted them. She said I would understand when I read the contents. The envelope was simply addressed to the postal inspectors in Westbury, New York, and had no return address. When I read the letter inside the envelope, I knew why nothing had been done with the previously received ones. The letter simply said, “There is a fraud in Long Beach, New York. Do something about it.” There was nothing else provided in the letter. The letter was postmarked Long Beach, New York.

Think about it. What if you received a letter alleging a fraud of some unspecified type occurring in a particular town and nothing else? Since it was addressed to the postal inspectors, I assumed that the sender knew that whatever the scheme or scam was, it was related to the Postal Service and the U.S. mail. I had no idea if this was a crank letter or legitimate, so I retrieved the earlier letters, but they contained even less information. I checked for any possible open cases related to Long Beach and there were none. I asked the other inspectors in the office if they had any knowledge of any frauds, thefts, or other crimes or related investigations in and around Long Beach, and they all said no. I didn’t know what more I could do with the scant amount of information provided, let alone if there was any truth to it.

Long Beach, New York, is a town of approximately 33,000 residents located on Long Island’s South Shore. It is a bedroom community for many people who work in New York City. Long Beach is known for its beautiful beach that stretches the length of the town and a once-famous boardwalk. Long Beach was the site of a number of scenes in The Godfather, but what it wasn’t known for was fraud.
With very little actionable information to go on, there wasn’t much I could do with the anonymous letter, so I opened a file folder and placed the letter I received, the prior letters the office received, and my minimal notes inside. And then I waited, not knowing whether I would ever receive any more letters or information.

A few months later a similar letter arrived. It was again addressed to the postal inspectors in Westbury, New York, with no return address and the Long Beach, New York, postmark. The letter inside now said, “There is a big fraud going on in Long Beach, New York. I’ve been sending you these letters before and nothing has been done to stop the fraud. Why aren’t you doing something? What’s wrong with you?” Like the earlier letters, there was little to go on, but I sensed that the writer had some basis for this continuing letter campaign and wasn’t just someone with a screw loose. Yet, there wasn’t much I could do. I contacted the Long Beach Police Department and other federal investigative agencies in case they were conducting a fraud investigation in the area that might be related. Again, I struck out, so I placed the letter in the file with my notes and again waited.

Several months later, another letter arrived. This time the letter inside was much more revealing. The letter said, “I have been telling you about this big fraud in Long Beach for many, many months and yet you have not done anything to stop it. What do I have to do? Investigate it myself? This is the last time you will hear from me. I hope you can finally do something with what I am providing you.”

For the first time, the sender inserted something else inside the letter. It was the key to the fraud he or she was alleging. It was a photocopy of a Postal Money Order. The U.S. Postal Service issues money orders at its post offices throughout the country. They are similar to money orders purchased at banks and other financial institutions and can be used for the same purposes as any check or money order. Postal Money Orders can be cashed at any post office and can also be negotiated at any bank or financial institution, and they are always valid as they never expire.

I looked at the photocopy with relish because now, I finally had a clue to go on. The money order was in the amount of $65.05, dated January 1, 1979, and issued in ZIP code 08300. This is the ZIP code for St. John, Virgin Islands. The payee was Bi-Organic Brands, a mail order vitamin company located in a town next to Long Beach. A name was listed as the payor, and there was a notation that the money order was for a mail order transaction. The writing on the money order was made with a pen. While I only had a photocopy, I tried to determine whether the money order was a counterfeit. It didn’t appear to be a counterfeit, but I would need the original to determine that.

I still couldn’t tell from this copy what the big fraud in Long Beach was. There was nothing associated with Long Beach on the money order, and it wasn’t purchased there. Still, the payee was a company located close to Long Beach, so there had to be some connection. I needed the original to learn more, including where it was actually negotiated and by whom. I requested the original money order from the Postal Service Money Order processing and storage facility in St. Louis, Missouri. I had no idea what I would find when I received the original, but I would again have to wait until it arrived. I had already waited this long, so what were a few more weeks?

When the original Postal Money Order arrived at my office, I quickly realized that the frustrated tipster had been right all along. The original money order had different information from the photocopy, yet both were the same money order. They both were in the amount of $65.05, dated January 1, 1979, and issued in ZIP code 08300. However, the payee was different; this money order was made payable to Bloomingdale’s Department Store. The same person’s name was listed as the payor, but there was a different notation at the bottom of the money order. The writing on the money order was made with a black marking pen.

Someone had used a black marker to write over the original written information, obliterating it and adding a new payee. The black marking pen covered up the original payee, and while it wasn’t the most professional alteration, it had worked in this case. It was clear to me that what I had before me was a money order alteration scheme. One or more fraudsters were obtaining Postal Money Orders and were altering and negotiating them in violation of federal statute.

Somehow the tipster had gotten hold of an original money order before it was altered, made a copy, and mailed it to us. The tipster had to be someone familiar with the scheme to have access to the money
order, and to be able to take it, copy it, and send it to the postal inspectors. I didn’t think the tipster was
someone involved in the fraud, because that would be self-defeating. It had to be a family member or
friend who knew of the fraud and wanted it to stop.

My instincts told me that although I had only one altered money order, there had to be many more. Now I
had to determine who was involved in the scheme, the extent of the scheme and the victims, how
much money was involved, and obtain evidence to prove any possible criminal violations of law.

The altered money order was used to pay outstanding credit card charges at Bloomingdale’s. While
the money order did not list the credit card account number, I knew that finding the owner of this credit
account was the first step in the investigation. I obtained a grand jury subpoena requesting all ac-
count information related to this money order, including copies of all payment instruments for monthly
statements, and served it on Bloomingdale’s, and the store produced valuable evidence. The card was
listed to a Sylvia Stempel who lived in Long Beach. But even more important, Bloomingdale’s provided
copies of numerous Postal Money Orders used for the monthly payments to this credit card account. Each
of the money orders had the same black marker writings covering original pen writing.

My investigative instinct told me that Stempel most likely was an employee of Bi-Organic Brands
and was stealing the money orders while working there. The money orders were most likely payments for
incoming vitamin orders. Stempel probably worked in order processing and had access to the incoming
mail orders and the payments that were included. But it was just a hunch. Bi-Organic Brands was a mail
order vitamin company located in Island Park, New York, that also went by the name of Sturdee Health
Products. There was also the possibility that the ownership of the company was somehow involved in the
fraud, but I didn’t think so and took a chance on reaching out to the owner of the company.

I did not want to provide advance notice to the company that I would be stopping by, as I didn’t know
what role Stempel or others involved might have. I arrived without an appointment and asked for the pre-
sident, saying I was from the U.S. Postal Service and had some inquiries. That was a true statement as I
did work for the Postal Service, but I didn’t want to identify myself as a federal agent. Once I was ushered
into the president’s office, I identified myself as a federal agent. I explained I was investigating an altered
money order scheme and I believed that the company and some of its customers were victims.

I showed the president the original and copy of the money order and told him that the subject of the
investigation was a Sylvia Stempel. The owner was shocked to say the least. He told me that Stempel was
a long-term employee of Bi-Organic Brands/Sturdee Health Products and was in charge of the mail order
department. In that role, she was responsible for opening all incoming mail orders, filling the orders, and
depositing the checks and money orders sent in for the orders into the firms’ bank accounts at a nearby
bank. I also learned the names and titles of other people who worked closely with Stempel in the order
processing department. I told him that I believed Stempel and possibly others were stealing money orders
from incoming mail orders and altering them for their personal use, such as the Bloomingdale’s credit
card payments.

I needed to know the extent of the fraud and who else was involved from the company. After the
president explained how the mail order processing system worked, I had an idea how to determine the
extent of the fraud. I asked the president for his cooperation and he agreed. I told him that I wanted to
attempt to identify incoming money orders before they were stolen. I learned that mail that came in on
Saturdays would be opened by someone other than Stempel, who was off on Saturdays. The opened mail
would then be left for Stempel to process when she returned to work on Monday.

I asked the owner to photocopy all checks, bank money orders, and Postal Money Orders from the
Saturday deliveries and provide them to me. I wanted a record of all incoming financial instruments. It
was my belief that Stempel would steal the Postal Money Orders and fraudulently negotiate them. I would
have to wait several weeks for the money orders to be processed, and then request the originals from the
Postal Service Money Order processing and storage facility.

Each week I would receive photocopies of dozens of Postal Money Orders that came in to the compa-
ny. Every few weeks I would request the original negotiated money orders. As expected, each of the orig-
inal money orders that I received had been altered. They were used as payment for MasterCard and Visa
credit card accounts, department store credit card accounts, and other payments.
I requested grand jury subpoenas for these new accounts and learned that Stempel had a partner in crime. Besides Stempel’s accounts, we found accounts in the name of Julia McMann, who worked with Stempel in the mail order processing department. Both Stempel and McMann were employed by the company and had been intercepting incoming mail orders containing money orders.

We also found something else very interesting. We found that a number of the money orders were cashed at a local bank. It was the same bank where the company had its bank accounts, and the money orders were not being deposited into the company accounts. Something wasn’t right, so I contacted the security department at this bank and explained my case. Working with the bank investigators, we found that the bank manager was cashing the stolen money orders and negotiating other funds for Stempel and McMann.

In order to fraudulently process even more stolen money orders, the subjects enlisted the assistance of Denise Gorsky, who was a friend and the manager of the bank where Bi-Organic/Sturdee maintained its bank accounts. Stolen money orders were provided to the bank manager who bypassed established bank procedures to cash the money orders, and for her assistance in the conspiracy, the bank manager received a cut of the proceeds.

Ultimately, this became a multiyear, multiple defendant case of two company employees and a bank manager conspiring to defraud Bi-Organic Brands and Sturdee. The fraudsters were stealing cash and money orders, but fulfilling the orders. The customers who placed the orders got their merchandise, so there were no complaints. This was an internal control breakdown. The beauty of the fraud scheme was that the employees exploited the lack of segregation of duties. The same people opened the incoming mail, fulfilled the orders, handled and deposited the payments, and recorded the orders in the company books as complete. The ownership of the company had full confidence in the employees because they had worked there for so long. The owners had no idea that their long-tenured employees were secretly defrauding them. In reality, the trusted insiders were fraudsters who had conducted their scheme for years.

The investigation determined that between December 1977 and March 1981, the defendants Stempel and McMann did fraudulently obtain, materially alter, and negotiate 436 Postal Money Orders totaling $15,218.65. They changed the payee and payor information and negotiated the money orders for their personal use. An additional amount of approximately $5,000 in Visa credit card charges and bank money orders were found to have been stolen by the defendants, and converted to their own use. In her capacity as a bank manager, Gorsky did fraudulently obtain, materially alter, and negotiate Postal Money Orders and embezzled Visa credit card funds.

Sylvia Stempel and Julia McMann pleaded guilty on February 17, 1982, to one count of Title 18, United States Code, Section 500, Counterfeiting and Altering of Postal Service Money Orders. Both were sentenced on April 16, 1982, and received two years of probation for their cooperation.

Denise Gorsky was indicted on July 26, 1982, in Brooklyn, New York on charges of Forgery of Postal Money Orders and Misapplication by a Bank Officer of Monies and Credits Entrusted to a Bank. She was arrested on August 3, 1982. Gorsky went to jury trial and was convicted on October 21, 1982. On December 10, 1982, she was sentenced to a three-year suspended sentence and a $5,000 fine.

We never learned the identity of the tipster, but it didn’t matter; he or she provided the information that got the investigation started. It took patience until the tipster finally provided the needed evidence, and then it was up to me as the case agent to move the investigation to a successful conclusion.

**New York State of Fraud**

The following case study is an excellent example of why patience is a virtue and how given enough time, along with commitment, energy, and expertise, fraudster greed can be used to a fraud investigator’s advantage.

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* The names of the individuals mentioned in this case study have been changed.
What I am about to tell you would make great fiction because it is so hard to believe that this could really happen. But this is a true story of a way of life in New York, where bribery, corruption, fraud, deceit, and greed were an everyday occurrence. A way of life that these fraudsters thought would never end. And it wouldn’t have if not for persistence, strong detective work, and some very good luck.

For many years, a conspiracy existed in practically every segment of the New York insurance industry to fraudulently inflate and stage property claims and collect the proceeds. The fraud was so pervasive that almost everyone involved in the claims process was in on the scheme, from the insured to the public adjuster (who represents insureds in claims against insurance companies), the company adjuster (who is employed by insurance companies to evaluate and settle claims), the independent adjuster (who is an independent professional who adjusts claims on behalf of insurance companies for a fee), the salver (who appraises damaged goods at the request of an insurance company), the accountant, the insurance broker, and other experts hired to verify claims.

Public adjusters are licensed professionals who adjust property claims on behalf of insured property owners. They typically work with the insurance company adjusters and other experts to determine a settlement amount to be paid to the insured. It was not uncommon for public adjusters and the insurance company adjusters to disagree on the amount of damage on a claim. New York State law limits public adjusters to a maximum 12.5 percent commission on a claim; the usual commission is 5 to 10 percent. Typically, the settlement check is sent to a public adjuster who subtracts the fee and remits the balance to the insured property owner.

This scheme involved kickbacks paid by public adjusters to the insurance company adjusters and other experts in order to compensate them for participating in the fraud conspiracy. Money for the payoffs came from the hugely inflated insurance settlements paid to the insureds, who then gave the public adjusters as much as half of the payments. The public adjusters then split the cash with the other participants in the scheme.

Years ago, the property claims community in New York was relatively small, so it became commonplace for the same public adjusters, company adjusters, accountants, and other experts to show up on claim after claim. This is how the marriages of corrupt adjusters expanded and allowed this fraud and corruption conspiracy to flourish for decades. Huge under-the-table payoffs and a strict code of silence kept this conspiracy going for 40 years.

Fraudulent property claims were submitted for both homeowner and commercial property losses. False claims were staged for as low as $10,000 and as high as in the millions of dollars. Legitimate claims involved water damage, vandalism, burglary, fire, and arson.

Defendants constructed machines to blow out powdered charcoal to simulate smoke damage. Pipes were installed only so they could be broken to create water damage claims. Tea was sprayed on walls to make them look like they had water stain damage. The fraudsters submitted fraudulent water damage, robbery, burglary, vandalism, and arson claims. Evidence was disclosed that this scheme had been in existence from at least the 1950s through the early 1990s.

Almost every major insurance company in the United States was a victim of this insurance fraud, including Chubb, Aetna, AIG, Cigna, Royal, General Accident, Kemper, Continental, Zurich-American, Hanover, USF&G, Home, Atlantic Mutual, St. Paul, Fireman’s Fund, Transamerica, and many others. They had no idea that their employees had been corrupted and were taking kickbacks—often in the millions of dollars—to approve fraudulent insurance claims. Many of the corrupt adjusters were openly living like millionaires on salaries of $50,000, but no one ever caught on.

The defendants in this case were respected members of their communities. They were managers of their children’s little league teams; they belonged to the PTA; they were active members of their local churches and synagogues; and they appeared to be upstanding citizens. Secretly, they were criminals joined at the hip and the wallet.

This investigation resulted in more than 250 prosecutions and convictions. The prosecutions were successful because of the identification of the numerous red flags of insurance fraud. The red flags found in this case were useful in detecting and preventing the fraudulent property claims.
Yet, this long-running and industry-wide fraud went undetected for decades, just waiting for a fraud investigator to discover it and pursue justice.

**Background and Detection**

From previous insurance fraud cases I had investigated in my career, I knew that insurance fraud in the property claims area was easy to pull off, financially lucrative, and hard to uncover. In 1989, a veteran insurance fraud investigator, who was a retired New York Police Department detective and who then worked for the National Insurance Crime Bureau, told me that a loosely knit but pervasive conspiracy existed in New York between all of the participants in the property claims settlement process. The conspiracy dated back 40 years and netted the conspirators millions and millions of dollars. This investigator said that there had never been a successful prosecution because no one had been able to crack the criminal chain and get anyone involved to talk. He told me that I was the perfect person to make this case.

I was flattered that this veteran detective thought I could successfully investigate and prosecute this fraud, but I also knew my limitations. When I asked what evidence was available to prove the crimes, I was told that there was none and that everything was conjecture. But this veteran detective was absolutely certain that the rumors and supposition of the insurance fraud conspiracy he had heard about for decades were true. I had worked with this investigator for many years and had great respect for him. I agreed to take on the investigation with one big stipulation: We had to find some evidence first.

I like challenges as much as the next person, but this one had impossible written all over it. I didn’t know where to start, but my experience told me to be patient. Patience and some luck would pay off and I would get that big break—and it happened within a year.

In the fall of 1990, an investigator with the Chubb Insurance Company advised me of several anonymous telephone calls she had received. Chubb had been one of the victim companies in a prior insurance fraud case I investigated. One anonymous caller named a Chubb adjuster as being involved in fraudulent claims and that the adjuster had received large payoffs. Another anonymous caller described a person who, while lounging at an exclusive country club on Long Island, New York, bragged about his fraudulent claims and all the money he made through his public adjuster. The public adjuster’s name was provided by the caller, and we finally had information to act on.

**The Investigation**

I started a task force to investigate this systematic and entrenched fraud and corruption conspiracy. The Postal Inspection Service joined forces with the Federal Bureau of Investigation, the Internal Revenue Service–Criminal Investigation Division, and the United States Attorney’s Office for the Eastern District of New York. Nearing a second retirement, the veteran insurance investigator joined our team. We initially pulled hundreds of claim files from Chubb where the named company adjuster and the public adjuster were involved. Later, we pulled files on other Chubb adjusters.

Months were spent reviewing these thousands of paper files for the red flags of insurance fraud. There were files without back-up documentation, files with no photos or photos that failed to show the claimed damage, mistakes as to the date of occurrence, field drafts routinely issued that did not require higher-level approval, files for claims paid within days of the occurrence, photos of damage already claimed in prior losses, multiple losses with the same insured, and other files missing from storage. They were all red flags signaling insurance fraud, and so these and other suspect claim files were targeted for further investigation.

We found numerous suspect claim files where the same subject adjusters were all involved. We learned the names of others who were involved in the suspicious insurance claims, and our list of suspects quickly grew. Following the concept of six degrees of separation, we connected company adjusters with public adjusters. The common denominators in each claim were the public adjusters who had orchestrated the frauds and had paid the kickbacks.

I then contacted other insurance companies where these same public adjusters had been involved and requested those files. Some insurance companies voluntarily provided their files while others required a
grand jury subpoena. Soon, there were thousands of additional files to examine, and the expanding review process took even more months to complete. These were hardcopy insurance claim files containing reports, notes, photographs, and other documents. We found more and more red flags of insurance fraud. We now had both homeowner and commercial claims that appeared to be fraudulent. Many of them were settled for millions of dollars.

In the fall of 1991, the task force began to interview homeowners about their suspect claims. Homeowners were fairly easy to roll over. They typically had filed few fraudulent claims and were quick to reveal the names of the public adjusters who involved them in the fraud. As the investigation progressed, other false claims and additional information were brought to our attention by insurance companies, attorneys, investigators, informants, and cooperators.

The task force placed video cameras in the homes and offices of cooperators to catch discussions of fraud and cash payments as kickbacks. We even caught one public adjuster on video instructing an insured (our undercover informant) how to stage a burglary claim rather than set a fire. The informant asked the public adjuster whether it was better to stage a burglary claim or just torch the house. “Are you a moron?” the public adjuster asked our undercover informant incredulously. “That’s arson. You never want to set a fire because that brings in the cops and fire marshals. Do a staged burglary instead. No one asks questions and everyone gets rich.”

This particular public adjuster had a predisposition for fraud. In his prior job as the owner of a pest control business, he would surreptitiously sprinkle dead termites in the homes of those he was inspecting. “Oh my goodness,” he would exclaim. “You have a serious termite infestation that I will have to quickly treat to prevent further damage to your home.” This public adjuster and many other suspects that we either identified from suspect claims or caught in undercover operations were quietly arrested and agreed to cooperate with the government in its ever-expanding investigation. Others did not need to be arrested as they quickly cooperated as soon as we approached them about their involvement in insurance fraud.

After reviewing hundreds of claims files, I could tell, just by reading it, if a claim was a staged claim and who did it. Certain public adjusters staged damages in particular ways; these were the individual signatures of those who worked the fraud. Some liked to break water pipes; some watered down premises with hoses; some used smoke machines; and others brought in damaged merchandise from additional locations to create seemingly more damage. Others were fearful of actually staging a claim and instead just grossly inflated legitimate occurrences.

The investigation continued. In December 1992, we executed search warrants at the offices of five public adjusters, many of them on John Street, the insurance center of New York, and one independent adjuster. We unsealed the indictments of 24 more people, including public adjusters, company adjusters, salvors, and others. Mary Jo White, then acting U.S. attorney for the Eastern District of New York, stated in their press release that “the investigation has uncovered unusually brazen efforts to defraud insurance companies. The indictments address an increasingly serious problem of entrenched, systemic fraud in the insurance industry.” The case went public and almost immediately, numerous defendants and targets not yet charged came forward to work out plea agreements and cooperate with the government.

In one newspaper, I was quoted as issuing a warning to people involved in the fraudulent insurance claims, saying, “Hire a lawyer and come and see me now, or we will be seeing you later.” This and the massive media publicity helped advance the investigation.

The public adjuster named by the anonymous caller to Chubb was among the first public adjusters to realize that his life of crime was over. Shortly after his indictment, and with the mounting number of cooperating defendants willing to testify against him, he decided to plead guilty and cooperate with the government’s investigation.

The public adjuster described how he and other criminally minded public adjusters realized 40 years ago that they could make a fortune in the growing property claims business through payoffs to insurance company adjusters. Most company adjusters were making very low wages in those days, and it wasn’t hard to persuade them to commit fraud with cash under the table. The public adjusters described the importance of getting all the participants in the claims process “on board with the program.” Once they got on the money train, they couldn’t get off. The public adjuster admitted he was shocked that the fraud and
corruption lasted for so many years before it was discovered. “All good things come to an end, but I didn’t think it would last this long or end this way,” he lamented.

This public adjuster provided the names of hundreds of homeowner and commercial insureds, company adjusters, and other experts he conspired with over his long career in fraud. He also described the stacks of cash he had handed out to his co-conspirators over the years.

**Prosecution and Trials**

We had our first trial in April 1993. The claim involved E. Vincent Leather and Luggage, a chain of leather goods stores in the New York metropolitan area. On May 16, 1991, an arsonist set fire to a store at the Walt Whitman Mall on Long Island, New York. The arsonist was a store security guard in the mall. Two people died in the fire, and the arsonist was convicted and sentenced to prison. E. Vincent Leather and Luggage suffered some damage, but the claim the managers submitted to the Transamerica Insurance Company was grossly inflated. Herman Birnbaum was the public adjuster, Joe Rodriguez the adjuster for Transamerica, and Kevin Bailey was the salvor. Birnbaum, Rodriguez, and Bailey conspired with the insureds to inflate the claim from less than $10,000 to $92,000.

The claim would have been paid if not for one slip-up: On July 17, 1991, Cliff Thompson, the son of the owner of E. Vincent, Lester Thompson, was having dinner with his best friend, Neal Simmons. Simmons was the E. Vincent insurance broker. During dinner, Thompson bragged about their inflated claim, and Simmons became concerned and called Transamerica and advised them of the fraud. Transamerica outfitted Simmons with a tape recorder and Simmons recorded incriminating telephone calls with Thompson and Birnbaum. Transamerica then advised me of the fraudulent claim and I took over the investigation.

I confronted Joe Rodriguez, Cliff Thompson, and Lester Thompson about their involvement and they confessed. Birnbaum had been previously indicted and had agreed to cooperate. Kevin Bailey was indicted and went to trial. At the trial, accomplice testimony and documents were used to prove the fraud. Birnbaum and Rodriguez testified as to their involvement with Bailey in this fraudulent claim and the promise of cash payments in return for aiding the fraud. Cliff Thompson testified that he created a false inventory on his office computer that more than doubled the actual store inventory. Thompson also testified as to the actual amount of damage that occurred and what he told Simmons.

An accountant who was not involved in the fraud testified that he couldn’t verify the inventory used or the damage estimate that Bailey came up with. An attorney who was not involved in the fraud testified that Bailey could provide no records showing how he verified the actual inventory and the amount of damage. This attorney also testified that Bailey refused to sign an affidavit as to the inventory and damage estimate he prepared and submitted to the insurance company. Finally, a store manager who had no part in the fraud testified to how much inventory was in the store and how much damage really occurred. At the conclusion of the trial, Bailey was found guilty on all the counts of mail fraud and was sentenced to prison. While neither the claim nor the promised bribes were ever paid, we were able to convict Bailey. After the trial, other defendants awaiting trial decided to plead guilty rather than face certain conviction, and no chance to lessen their possible sentencing, by accepting responsibility for their criminal acts. *

In August 1993, we executed search warrants at the offices of seven additional public adjusters and another independent adjuster. In September 1993, the government unsealed indictments of 39 more individuals including insureds, public adjusters, company adjusters, independent adjusters, salvors, accountants, brokers, and investigators. In short order, most of the defendants pleaded guilty.

The second trial took place in November 1994. The trial involved a series of insurance claims filed by United Utensils, a plastic and steel container manufacturer located in Port Washington, New York. Chubb was the insurance company for United Utensils. The defendant on trial was Ralph Murray, whose real name was Ralph Miller. Murray was a machinery and computer expert hired by insurance companies to determine and appraise amounts of damage. Murphy was the brother of Chubb adjuster Karl Miller. Murphy would receive loss assignments from his brother, and to avoid arousing suspicion and the possibility

* The names of the individuals mentioned in this case study have been changed.
of conflict of interest charges, he used the name Murphy. No one knew that they were brothers, and they wanted to keep it that way.

The public adjuster for United Utensils was again Herman Birnbaum. Karl Miller and Ralph Murphy had an agreement with Birnbaum that they would receive cash for inflating claims with him. Phil Turner was also a Chubb adjuster and was involved in some of the United Utensils claims. He, too, had this standard agreement with Birnbaum to receive payments for inflating claims. An accountant retained by the insurance company was also in on this scheme. Bernard Fine was the owner of United Utensils and conspired with Birnbaum and the others to fraudulently inflate these claims and pay kickbacks.

Murphy was charged with seven counts of mail fraud involving a fire and water damage claim that occurred on January 4, 1989, for which Chubb paid $378,000 and a water damage claim that occurred on December 26, 1989, for which Chubb paid $150,000. Murphy received his payments for claiming that undamaged machinery in the plant was damaged beyond repair. Birnbaum, Fine, Turner, and the accountant all testified as to their involvement in the fraud with Murphy, and the payment of the bribes. A volunteer fireman who responded to the scene testified that he saw little damage—under $10,000 worth. The United Utensils’ bookkeeper testified that she was aware of the cash payments and in fact had gone to the bank to withdraw the cash for the payments.

Several employees of United Utensils, who had no part in the fraud, testified that the machines that Murphy claimed were ruined were not damaged and were still in working order. One of these machines was located in another state and was photographed almost five years after the original claim. Murphy claimed this piece of machinery was damaged beyond repair. The photographic and witness testimony showed it was still in working condition, proving the crimes without a doubt.

Prior to his indictment, I interviewed Murphy at his home. He made some admissions but also lied about some aspects of his involvement, and this was also introduced at trial. Murphy testified in his defense and the government was able to prove that he perjured himself while on the witness stand. At the conclusion of the trial, Murphy was found guilty on all counts, and was sentenced to 30 months in prison, 3 years’ supervised release, and a $20,000 fine.*

The enormity and long time frame of the conspiracy benefitted us as investigators. While it might be possible for a defendant to fight criminal charges on one or two acts of corruption, it was impossible when one committed dozens if not hundreds of such acts. With each new plea, the conviction steamroller picked up speed with more and more defendants lining up to plead guilty.

The New York Insurance Fraud Task Force investigation resulted in charges and convictions against 256 individuals for insurance-related fraud, conspiracy, and tax evasion. The sentences handed out to the defendants ranged from probation to 15 years in prison for a series of arson-for-profit cases. Sentences generally included fines and court-ordered restitution. The largest fine was $1 million, and the largest court-ordered restitution was more than $235 million. Many of those charged were also hit with civil Racketeer Influenced and Corrupt Organizations (RICO) lawsuits filed by the victim insurance companies. Twenty-six search warrants were executed during this investigation.

The following is the allocution before the court at the time of pleading guilty by one of the public adjusters prosecuted in this case:

As to Count 1, in 1991, the claim was staged, meaning that the damage was created for the purpose of submitting a false insurance claim. My role included taking a machine which I purchased and using that machine to blow powdered cement to appear to be smoke damage. Together with the participation of the insured and others, the claim was submitted to Aetna for payment. Apart from the staged damage, the claim submitted to Aetna was also inflated.

As to Count 2, in 1989, the claim was staged. I had discussions with the insured about staging the claim. This included having the plumber install a urinal with the intent of the urinal being broken. Other employees of the firm had broken the pipe from the urin-
nal. The ceiling was also ripped down to make the damage appear worse. The claim was then submitted to Aetna for payment. Apart from the staged damage as submitted to Aetna, it was also grossly inflated.

As to Count 3, the claim was staged. I had discussions with the insured about staging the claim. We agreed that the claim would be staged. Later other employees of the firm sprayed down the premises with water hoses and pulled down ceiling tiles to simulate real damage. The claim was then submitted to Aetna. I was aware that an Aetna adjuster was supposed to receive a cash payoff for his part in making the claim. A salvor was to receive money as part of this.

Additionally, in the course of my career as a public adjuster there were pipes broken to create water damage. I’ve used hoses to spray water on goods to simulate damage. I’ve brought into a loss previously damaged merchandise from other loss sites so the insured could claim the previously insured merchandise as his own.

I’ve sprayed walls down with water in which tea has been diluted to give the appearance of water-stained damage. I’ve torn down ceiling tiles to simulate ceiling collapse. I’ve adjusted burglary claims where I knew the burglary was staged by the insured with the assistance of the public adjuster.

What was unusual about this investigation was that the conspiracy existed for so many years without being detected. The defendants felt they were immune from prosecution because no one had actively investigated this type of fraud before and they felt that no one would squeal on them. Even those not directly involved in the fraud accepted it as a way of life and did nothing to stop it. In addition, the large number of prosecutions in one case is extraordinary.

Lessons Learned

This investigation was a learning experience for my team of investigators and me. Prior to this, I had never had a case with so many defendants and so many documents. The numerous search warrants and grand jury subpoenas yielded hundreds of thousands of documents that all had to be reviewed. In order to store, inventory, and review the documents, a warehouse-size building was needed. The amount of time and dedication required by me and my investigative team to examine the evidence was extraordinary.

We again learned never to give up. Our motto was keep your eye on the prize. Large and complex cases take time, and the team realized that cases such as this could take years to complete and everyone was committed for the long haul. We also knew that this was a very special case. Organization was critical, and we didn’t allow ourselves to be overwhelmed by the volume of paper.

A systematic review allowed us to remove the wheat from the chaff, resulting in key and smoking gun documents. Computers greatly increased our productivity. Embracing and effectively using technology can significantly improve investigative results. We also realized that in order to successfully investigate fraud in the insurance business, we needed to know the industry. That included education in how the business works, how insurance claims are filed and paid, the roles of the various participants in the claims process, and the terminology and lingo. The time and effort paid off, because whatever industry or business a fraud examiner investigates, it is absolutely critical to know how it operates.

We needed to use every available tool in the fraud examiner’s tool kit. That included undercover operations, physical and electronic surveillance, search warrants, subpoenas, “flipping” defendants into co-operators, publicizing indictments and arrests, as well as adding tax evasion charges for the unreported cash payoffs. We even used a RICO indictment against one of the public adjusting firms.

Something else was reinforced for us: knowing the case inside and out. We found it extremely beneficial to constantly review our notes and reports, as well as our key evidence. With hundreds of defendants, witnesses, associated notes, and the large volume of evidence, there was always something discovered or remembered when we went back through everything again. We also found that by having a small number of investigators who stayed together for most of the investigation, we retained our historical knowledge of the case.
Prepare, prepare, and prepare some more for possible testimony, whether at trial or any other related proceeding. You never know what question you will be asked, and your knowledge of the case could make or break the outcome. And be patient.

**Recommendations to Prevent Property Insurance Fraud**

Property and casualty insurance fraud costs consumers and insurance companies an estimated $30 billion a year. The best way to combat this fraud is to learn to recognize the warning signs of fraud and utilize prevention techniques. This case was successful because we identified numerous red flags of fraud and corruption, and were unrelenting in our investigation.

**Understand Fraud Risk**

We found that management at the victim insurance companies had no idea that this corruption and fraud was going on. An executive at one of the companies told us at the beginning of the investigation that he would stake his reputation on the honesty of his adjusters. Furthermore, he stated that he believed that fraud has a minimal impact on his business. He was wrong on both accounts, since at his company alone, we convicted four of his adjusters and the losses were in the millions of dollars.

Those involved in the insurance industry must be aware that insurance fraud is a constant threat that results in billions of dollars in losses every year. Management of every organization needs to perform an ongoing fraud risk assessment and take appropriate action to mitigate those identified risks.

**Rotate Employees**

This conspiracy was successful for so long because the same company adjusters were allowed to work the same territories, with the same public adjusters and other external personnel year after year. Had adjusters been rotated, the *fraud marriages* may have been broken up. Rotation of employees in key roles is an internal control that should be always considered.

**Respond to Rumors**

Throughout the investigation, we learned that there were numerous rumors of unexplained wealth and extravagant lifestyles on the part of the company adjusters. In many cases, it was evident that the subjects were living beyond their salaries, but no one with authority did anything about it. One company executive told us that a particular adjuster was always providing investment information to other employees on what stocks and bonds to buy, but the warning bells never sounded.

In another example, an adjuster was living in a million-dollar home on a salary of $40,000. Yet, no one ever acted on this information. The corruption in this case was so vast that the illicit cash flowed like water. Rumors and other questionable activities must be appropriately and professionally investigated.

**Review Claim Files**

One of the constants that we found was a lack of a thorough review of the claim files by insurance company claim representatives. Claim representatives must be thoroughly trained in detecting fraud through identification of red flags and knowing how to escalate concerns. A second level review of claims files is also recommended.

**Ethics and Fraud Awareness Training**

Some of the victim insurance companies did not provide either ethics or fraud awareness training for their employees. This was a critical lapse that may have contributed to the culture of fraud by those who committed fraud. Ethical conduct and fraud prevention training is needed on at least an annual basis for all employees. In addition, it is highly recommended that all employees be told whenever any employees or others doing business with the company are arrested or discharged for fraudulent activity. This demon-
strates to employees, customers, and investors that the organization takes a strong stand against fraud and abuse.

**Hotlines**
The anonymous calls that fueled this case did not come through a formal hotline. Instead, they were received ad hoc by employees. In fact, most of the victim companies did not have hotlines in place. All companies should institute hotlines to allow for anonymous and confidential reporting of allegations of fraud and violations of policy. The hotlines must be widely communicated internally and externally, but most important, all allegations received need to be thoroughly vetted and investigated.

**Certified Fraud Examiners**
Today, with the Certified Fraud Examiner (CFE) certification as the gold standard for fraud detection and prevention, organizations are better served and protected by having CFEs on their investigative staffs. Every investigative unit must have CFEs to detect, investigate, and prevent fraud. Fraud examination expertise is absolutely critical in fostering a climate of honesty and integrity in every organization.
Review Questions

1. What can significantly improve the outcome of a fraud investigation?
   A. Establishing a deadline for ending a fraud investigation
   B. Embracing and effectively using technology-based investigative tools
   C. Ensuring indictments and arrests are kept private
   D. Rotating investigators

2. What is an internal control that can prevent property insurance fraud?
   A. Physical and electronic surveillance
   B. “Flipping” defendants into cooperators
   C. Adding tax evasion charges
   D. Rotation of employees in key roles
Review Answers

1.  A. Incorrect. Establishing a deadline for ending a fraud investigation cannot significantly improve the outcome of a fraud investigation. Instead, large and complex cases take time, it is important to see the investigation through.
   B. **Correct.** Embracing and effectively using technology-based investigative tools can significantly improve the outcome of a fraud investigation.
   C. Incorrect. Ensuring indictments and arrests are kept private cannot significantly improve the outcome of a fraud investigation. Rather, publicizing indictments and arrests is a fraud examiner’s tool for gathering information.
   D. Incorrect. Rotating investigators cannot significantly improve the outcome of a fraud investigation. Instead, maintaining the same small number of investigators retains historical knowledge of the case.

2.  A. Incorrect. Physical and electronic surveillance is not an internal control that can prevent property insurance fraud. Rather, this is a tool used by fraud examiners to gather information.
   B. Incorrect. “Flipping” defendants into cooperators is not an internal control that can prevent property insurance fraud. Rather, this strategy is used by fraud examiners to ensure an investigation maintains forward momentum in gathering information.
   C. Incorrect. Adding tax evasion charges is not an internal control that can prevent property insurance fraud. Instead, this strategy is used by fraud examiners to gather information in a fraud investigation.
   D. **Correct.** Rotation of employees in key roles is an internal control that can prevent property insurance fraud.
Chapter 6
Fraud Can Be Murder

Learning Objectives

- Ascertain what is first and foremost in any investigation

Introduction

Early in my career I was told that fraudsters are only interested in separating victims from their money and that violence is not something I needed to worry about. Fraudsters are supposedly too smart to ever rob a bank and face a life sentence in prison when they could steal far more from schemes and scams and only face a fraction of the jail time. Violence is left to blue collar criminals, drug dealers, and street thugs. The premise that fraud is a nonviolent crime made sense when I was young and inexperienced. But that premise was quickly proven wrong as I learned firsthand that even fraudsters can commit violent and harmful acts, including murder.

When you investigate fraudsters, you have a dramatic impact on their lives. Your investigation may result in their being sentenced to prison and losing their freedom, their families, and more. You just never know how a person will react under those life-changing circumstances. I have seen people so devastated by their involvement in fraud and subsequent discovery that they attempted suicide, and others who succeeded in committing suicide. A senior director at a global technology company ingested antifreeze after his $9 million software theft and fraud scheme were discovered and he was arrested; he died several days after drinking the lethal liquid.

Be prepared for the unexpected, because you never know what else that fraudster may be involved in. You may think you are just conducting an interview of a fraudster or even a witness at his or her home, but the subject may also be a drug dealer or involved in smuggling weapons, and not know your true purpose. I’ve had fraudsters pull guns and knives and resist mightily when arrested. I once had a 60-year-old acupuncturist use taekwondo on me and other investigators when we arrested him on fraud charges. Your safety is first and foremost.

In 1983, I investigated a group of young men and women who were involved in credit card fraud, check forgery, welfare fraud, and identity theft. These were white collar crimes and the defendants were facing minimal jail time or even probation because of their ages and no prior criminal convictions. When the investigation escalated to the prosecution stage, the leader of the conspiracy decided to take action to end the investigation. He naively thought that if he killed both the federal agent (me) and the prosecutor, somehow that would make the case go away. He tried to hire a hit man to kill the prosecutor and me, but no one would take on the murder of two feds.

The fraudster instead decided to murder the two people he thought were informants for the government. As before, he was unsuccessful in trying to convince anyone to kill on his behalf so he decided to murder the informants himself. He convinced the informants that they were going out for a night of partying. When their guards were down, he shot them both in the back of the head and dumped their bodies in an alley in Brooklyn, New York. We arrested him for the murder and convicted him of the double homicide and also the fraud charges. He was sentenced to life in prison. Whenever someone would say that fraud is nonviolent, I would remind the person that is just not so.

We know that fraud can have a financial and emotional impact on victims. The loss of one’s life savings can be emotionally devastating. Fraudsters use many approaches in their schemes. I have seen medical quackery drugs that promised cures for cancer and incurable diseases only to leave victims potentially harmed. I have investigated fraudsters who posed as doctors to administer dangerous medical procedures that left victims scarred and potentially facing death. I have seen contaminated food products sold as safe
and pure. I have seen numerous fraud schemes that employed violence and abuse as elements of their crimes. Those cases and others are profiled in this chapter.

**Good Humor Ice Cream Scandal**

Do you remember the Good Humor ice cream trucks when you were growing up? The white trucks with Good Humor logos and white-uniformed drivers would go up and down neighborhood streets in the summers ringing bells and selling ice cream to children and adults. The trucks were a welcome sight and a relief from the summer heat. Cold and delicious ice cream is a treat that is hard to resist. In 1974, Good Humor would turn out to be my first big case and my first involvement with informants.

Good Humor was an American institution. Yet the company’s Maspeth, New York, manufacturing plant forgot about its valued reputation when it decided to falsify business records submitted to the state health inspectors, to hide the bacteria and insect contamination of its ice cream products. I was initially contacted by two whistleblowers from the company who were having pangs of guilt and wanted authorities to know about the criminal activity at their company. They had also read about recent disclosures of similar wrongdoing at another milk processing company and that reinforced their need to come forward.

I investigated the case, but was definitely learning as I went. I started a job as an inspector for the New York State Department of Agriculture and Markets in January 1973, right out of college. My work involved regulatory inspection and investigation of food products, including those contaminated and unfit for human consumption. I was just starting out and had not received any formal training in investigating fraud. But I did have two very good New York Police Department detectives who helped me in the investigation and I learned a lot from them. We got a search warrant, conducted interviews, found evidence to support the allegations, and indicted the company. I learned that fraud had more than just a financial impact. It also had a reputational impact and it could harm people, literally and figuratively. But I also came to learn the value of informants, something I would never forget throughout the rest of my career.

**The Value of Informants**

In November 1974, I was contacted by several former employees of the Good Humor Corporation who detailed a number of allegations of wrongdoing by the ice cream maker. The informants were lab technicians who all worked at the company’s ice cream manufacturing plant in Maspeth, New York. The informants alleged that the company pumped water into the ice cream mix to increase volume and lower fat content in violation of standards. The informants also alleged that there was a problem with roach and rodent infestation at the plant and that insect-contaminated ice cream mixes were disguised by adding a chocolate ice cream base and chocolate chips. The informants further alleged that bicarbonate of soda was added to neutralize sour milk acidity during the manufacturing process.

The most serious allegation was that the company knew of the high bacteria contamination and took steps to conceal it from government regulatory agencies. The informants alleged that the ice cream products had high bacteria counts and that special ice cream samples with known low bacteria counts were provided to state inspectors as test samples, while known high bacteria count products were not. The informants further alleged that Good Humor maintained two sets of books, one for health inspectors with falsified numbers showing normal bacteria counts of the ice cream manufactured, and another set of books that was kept hidden that documented the actual high bacteria counts.

After meeting with the informants, I prepared a detailed report and submitted it to my supervisor. My report was sent up to our headquarters in Albany, New York. When our legal department reviewed my report, it was decided that since this was a criminal matter, any further investigation and possible prosecution would be referred to the Brooklyn, New York, District Attorney’s Office. Good Humor’s Maspeth plant was located in Brooklyn and not in Queens as we originally thought. The DA’s Consumer Fraud Bureau handled the case, and I worked with the chief of the unit and other assistant district attorneys, as well as others from my department. Our first meeting was on February 28, 1975, at the DA’s office in downtown Brooklyn.
Search Warrant
After presenting the evidence, it was decided that immediate action was necessary to collect additional evidence for a possible prosecution. Working with an assistant district attorney, I prepared and swore to a search warrant. The search warrant for Good Humor’s business records and other evidence was issued by a justice of the Supreme Court of the State of New York, Kings County, on February 28, 1975. The following supporting narrative is from my search warrant affidavit:

On November 16, 1974, I received information from former employees of Good Humor that improper and unlawful practices were occurring at the Good Humor plant located in Maspeth, New York. Confidential Informant (CI) #1 exhibited to me “Daily Bacteria Reporting Sheet” records which he stated he had received between January 1974 and June 1974, in connection with his duties as a sanitarian at the Good Humor plant. CI #1 stated that said books contained an accurate record of the quality control tests of products manufactured in the Good Humor plant but that another set of Daily Bacteria Reporting Sheets for the same period were maintained by Good Humor with false information. He further stated that the second set of reports was used to indicate to representatives of regulatory agencies that the product being manufactured by Good Humor was meeting acceptable quality standards. He also stated to me that the purpose of the false records was to conceal high bacteria counts found in products which were manufactured and shipped to customers by the Good Humor plant.

CI #2 stated that she was formerly employed as a laboratory technician for Good Humor and that while so employed she was instructed by her superior to make false entries, with respect to the bacteria count, on Daily Bacteria Reporting Sheets. She stated that the false entries were made by dropping last digits from the actual number of bacteria found until the number came within the acceptable bacteria tolerance. CI #2 also stated that of her personal knowledge, false bacteria count records were filed with the State of Alabama and the United States Army and that she filed these records at the direction of the quality control manager, in addition to the maintenance of such false records in the Good Humor plant for examination by representatives of New York State and New York City regulatory agencies. She also stated that she recorded the correct figures on Daily Bacteria Reporting Sheets which were kept for internal quality control purposes.

On November 19, 1974, CI #1 turned over to me copies of the Daily Bacteria Reporting Sheets for the period January 1974 to June 1974 which copies he had previously exhibited to me. He again stated that said records reflect the accurate quality control test results for the aforesaid period, and that these reports had come to him in the course of his official duties with Good Humor.

The Assistant Director of the Division of Milk Control of the New York State Department of Agriculture and Markets informed me that the records given to me by CI #1 are not in agreement with the information obtained by inspectors of the Division of Milk Control in the course of their regular duties which duties include the examination of Daily Bacteria Reporting Sheets which are required to be maintained by Good Humor and open for inspection by Department inspectors.

The Assistant Director also informed me that the quality control records exhibited to Dairy Products inspectors indicated that the products being tested were within acceptable bacteria tolerance, whereas the Daily Bacteria Reporting Sheets supplied to me by CI #1 indicate that a great many of the products tested over said period of time did not meet quality standards for frozen dessert products.

On November 19, 1974, CI #3, a former laboratory technician of Good Humor, stated that he was instructed by the person in charge of the quality control laboratory to make false entries on Daily Bacteria Reporting Sheets which were being kept for the pur-
poses of inspection by governmental regulatory agencies. CI #3 said that he was also directed to maintain accurate Daily Bacteria Reporting Sheets, such as those presented to me by CI #2, for internal plant purposes. CI #3 stated to me that, to his personal knowledge, products which exceeded acceptable bacteria count levels were shipped by Good Humor for distribution and sale.

CI #1 stated that the correct records with respect to bacteria testing results were usually maintained in the top drawer of a desk located in a quality control room of the Good Humor plant. He stated that a present employee of Good Humor informed him that the accurate records had been moved to another location within the plant. He also stated that a warning system is in effect at the Good Humor plant to make employees aware of the entry to the plant of representatives of a regulatory agency, so that any possible violations and the true bacteria reporting sheets may be concealed.

CI #1 stated that the Good Humor Corporation is planning to close down its frozen dessert manufacturing plant in Maspeth sometime in April 1975.

CI #4, another former employee of Good Humor stated that while he had not personally participated in or witnessed the unlawful practices alleged by CI #2 and CI #3, he had been informed by other Good Humor employees that bacteria testing records were being falsified at the plant and that water and bicarbonate of soda were being unlawfully added to frozen dessert products.

We executed the search warrant on March 3, 1975, and numerous books and records were seized providing evidence that supported the allegations. Following the search warrant, Good Humor closed its Maspeth plant in April 1975. I testified before the grand jury in June of that year.

Indictment
On August 7, 1975, the Brooklyn District Attorney’s office indicted the Good Humor Corporation on charges of “knowingly selling ice cream with excessive bacteria and failing to protect all its products adequately from dirt and insect contamination.” The 244-count indictment charged the company with falsifying records to hide excessive amounts of non-toxic coliform bacteria. Coliform bacteria are generally found in animal feces and are a common bacterial indicator of the sanitary quality of food. The 244 counts of falsifying business records was believed to be the largest number of counts ever handed up by a Brooklyn grand jury.

During the press conference following the indictment, the District Attorney stated that “the company kept two sets of books, one of which contained the true figures on the bacterial count of the ice cream and was kept confidential. The false records, which were shown to inspectors, were destroyed over a period of time beginning last November [1974].” The secret book with the actual bacteria counts “showed coliform counts on some batches of ice cream 200 times as high as the law allows.” Worse, many other batches were labeled TNTC—meaning that the bacteria were Too Numerous to Count.

Guilty Plea and Remediation
On April 1, 1976, the Good Humor Corporation pleaded guilty in Brooklyn Supreme Court to charges that it falsified its records of high bacteria counts in its ice cream and was fined $85,000. The company “agreed to spend $450,000 to modernize its plants in Baltimore and Chicago and upgrade quality control.” Good Humor also agreed “to establish and maintain an educational program for all employees on

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2 Ibid.
5 Ibid.
the law and sanitary habits and employees will also be encouraged to report violations to corporate officials and agreed to pay the state to conduct monthly tests of the ice cream.\textsuperscript{6}

While there was no evidence that anyone actually got sick from eating Good Humor’s ice cream products with excessive coliform counts, the bacteria had the potential to do just that. In addition, there was no excuse for the falsification of the bacteria records provided to enforcement agencies or the creation and maintenance of two sets of books.

**Bad Ham and Bribes**

In July 1975, I was inspecting the contents of a cold storage facility on Long Island, New York. A cold storage facility is a refrigerated warehouse for temporary and long-term cold or frozen storage of food products for wholesalers, importers, and retailers. This particular cold storage warehouse was very large with food products on pallets on rack shelving. The temperature in the cold storage freezer warehouse was −15°F. As I was walking around, I noticed several dozen hams stored on the concrete floor. The hams caught my attention because they were unwrapped; some were loose on a wood pallet, others were in broken boxes, and some were strewn directly on the concrete floor.

There were nearly 5,000 pounds of hams that looked and smelled awful. I conducted a simple test for possible spoilage. I rubbed my hands along the hams and the heat of my hands melted the surface of the hams a little. I then smelled the grease and liquid on my hands and the result was a foul smell. There was something definitely wrong with these hams, and my concern was that they were being stored in a facility for possible future food use. I learned that the hams belonged to a large wholesale and retail food market in Queens, New York.

The owner of the cold storage facility told me that the hams arrived at his warehouse unfrozen and he was uncertain of their condition at that time. I placed the entire lot of frozen hams under state seizure and I took a large ham for laboratory examination. In August 1975, the lab results came back as expected. The ham sample was found to be rancid, decomposed, slimy, odorous, high in E. coli (a bacteria that indicates fecal contamination that can cause food poisoning), and unfit for human consumption.

After receiving the laboratory results, I contacted Max Schneider, the owner of the food market, to discuss destruction of the contaminated hams. We scheduled an appointment to meet at the cold storage facility to look at the seized hams. I had serious concerns about why the hams were being stored rather than being destroyed, and my conversation with Schneider only reinforced my concerns. Schneider was not bothered by the apparent contamination and just wanted the hams returned to him. I had a nagging feeling that Schneider would offer me a bribe to release the seized items.

I was already working with the Brooklyn District Attorney’s Office on the Good Humor investigation and prosecution, so I discussed the matter with one of the assistant district attorneys. The assistant district attorney shared my concern and wanted me wired for any meeting with Schneider. The assistant district attorney wanted me to meet with Schneider in Brooklyn, New York, where they had jurisdiction. The cold storage facility was located on Long Island where they did not have jurisdiction.

On the previously scheduled meeting date, I told Schneider I was working in Brooklyn and was detained on another matter. I asked if he could meet me in Brooklyn to discuss disposal of the seized meat. He agreed and we met that afternoon in downtown Brooklyn. The telephone conversation was tape recorded by the assistant district attorney I was working with.

I had never worked any undercover assignments before then, and I had not received any training on how to conduct an undercover operation. Knowing that, I was given a quick training by the detectives and assistant district attorneys in the DA’s office in how to act, what to say, and what to do while undercover. There was a lot to learn in a very short time. I was able to absorb and understand almost everything they told me and for whatever reason, I felt very comfortable and confident that I could carry out the undercover work. I also knew that everything could not be scripted and I would have to rely on my instincts and improvise as necessary.

\textsuperscript{6} Ibid.
I was wired with a high-quality tape recorder called a Nagra from the company by the same name. Nagra produces superior portable professional audio recorders that were prized by the motion picture industry for their ruggedness and reliability. Law enforcement also found Nagra’s ruggedness, reliability, and many hours of high-quality recording capability very desirable for undercover operations, and I subsequently used Nagra devices throughout my law enforcement career with much success.

Besides the Nagra recorder, I was outfitted with a transmitter, so the backup team of detectives could monitor my conversations with Schneider. The Nagra was placed in the small of my back and the transmitter on my right side. An antenna was attached to my back. Two microphones were attached to the equipment and then to my chest, and the Nagra and transmitter were secured to my body with surgical tape to keep them from falling off. My entire torso was taped, and I felt like a mummy, but my undershirt and dress shirt covered the equipment. In later years, specially designed body harnesses with pockets for Nagras and transmitters were manufactured using Velcro to secure it to the body. These were far more comfortable and were standard issue for law enforcement undercover operations.

We discussed what to do if Schneider offered me a bribe, and it was decided that he would be arrested if that occurred. Although I had the transmitter on me for the detectives to hear what was being said, I knew that transmitters could be unreliable at times due to blocked transmissions from the construction of a building. I also knew that they can fail at the most inopportune times, so I suggested that we have a back-up signal just in case. I came up with the idea that since I wore glasses, I would remove my glasses if the bribe was paid. That would be the signal for the detectives to move in and make the arrest. If for some reason a bribe was not paid, I would leave my glasses in place and we would regroup to determine our next steps. I’m glad I came up with the glasses idea.

I was searched by the detectives and everything on me was inventoried, including any money I had in my wallet. This way we knew for sure how much money I was carrying and that any bribe money I might receive would be separate and apart from any of my personal money. This would minimize any defense claims that the bribe money was money I already had on me, and that no money had ever changed hands.

I arranged with Schneider to meet at a busy corner in Brooklyn. My back-up team of detectives was out of sight in the area watching me. I went to the corner, and Schneider drove up at the prearranged time in his red Mercedes sports car. He told me to get in so we could go for a drive. I had previously been instructed not to get in the car as my team was positioned in the area and we needed to control the situation and my safety. I told Schneider that I had not eaten all day and we should instead grab a late lunch at a nearby deli. Schneider agreed and parked his car.

We went inside the deli and sat down at a table. I made sure to sit facing the front window of the restaurant. Some of the detectives had positioned themselves in a parking garage directly across from the deli and were able to see us at the table through the front window using binoculars. Amazingly, I wasn’t nervous and felt confident even though this was all new to me.

We ordered sandwiches and started to talk. Schneider said that all the meat I had seized was not bad. I said that I saw the meat and also had lab results proving that the meat was unfit for consumption. I had the lab reports with me and showed them to Schneider. I told him that I was inclined to destroy the seized meat. That was when Schneider asked what he could do for me so I would not destroy the meat. I asked what he meant, and Schneider took out a pen, grabbed a napkin from the table, and wrote $500 on it. He pushed the napkin in front of me and asked if this would take care of the problem.

Schneider had offered me a bribe, but my dilemma was that the detectives listening had no idea about the $500 amount written on the napkin. I had to do something and instinctively I knew what to do. I said “five hundred” out loud and asked him what he wanted me to do for the money. Schneider said I would need to release the seized meat and he would quickly doctor it and dispose of it in any of several ways, including smoking it and making it into sausage. He assured me no one would ever know, so I agreed and asked if he had the money. He said he did not and would have to return with the money to pay me. We arranged another meeting at the same location for the next day. We left the deli and I made sure to leave my glasses on to signal that no bribe was paid and to allow Schneider to leave without being arrested.

I then met with the assistant district attorneys and detectives at the DA’s office. We discussed what had just transpired. There was a concern that Schneider would not go through with the bribe and that was
why he said he did not have the money on him. Yet, the tape recording of the bribe offer and our conversations were very clear as to intent. We decided to wait and see if Schneider made the meeting the next day.

The next day, I went to the DA’s office bright and early to get wired up and have a briefing. I again went to the prearranged corner to wait for Schneider. He drove up in his Mercedes, and like the day before, he wanted me to get in the car and drive around. But I again resisted and said I would rather do this on the street, and so he parked his car and we started walking. Schneider wanted to go to an Italian restaurant he knew of instead of the deli from the day before. But it was too crowded so we returned to the deli that was mostly empty. That was good since the detectives were again situated in the parking structure directly across the street.

We sat down at a table and made some small talk, and then Schneider passed his hand under the table and told me to take it. It was a wad of U.S. currency, and I reached under the table and took it. I held the money in my lap and counted it out loud; it came to the previously agreed upon amount of $500. I put the money in my suit pocket and asked him just exactly what I needed to do for the money. Schneider said I should release the seized meat to him, and he would take care of the meat by slicing it, soaking it in brine, or smoking it to disguise the spoilage and rancidity. He assured me that the meat would be completely hidden and impossible to trace, and that no one would ever know of our conversation and our deal. All the while, the Nagra was recording everything, and the detectives were listening intently across the street.

After several more minutes of casual conversation, we left the deli. As we walked outside, we shook hands and I took off my glasses as the prearranged signal. I walked away and Schneider went to his car. He was immediately surrounded by detectives and arrested. I went directly to the DA’s office. Schneider was taken to the DA’s office, read his Miranda rights, and questioned. He denied any knowledge or involvement with any bribes and said he had no idea what they were talking about.

To impress upon Schneider that we knew exactly what we were talking about, the assistant district attorney called me into the interrogation room. When Schneider saw me, he raised his index finger to his lips to let me know to keep quiet. He had no idea who I really was. The assistant district attorney told Schneider that I was an undercover investigator and I had been wired up. Everything we said had been recorded as evidence. He refused to talk any further and the questioning stopped. He was processed and placed in a holding cell for his arraignment.

The bribe money was counted, initialed, and dated by the assistant district attorney, a detective, and myself and placed into evidence. I was further debriefed by the assistant district attorney and detective. Schneider’s attorney came down to the DA’s office upon learning of his client’s arrest. The assistant district attorney played the tape recording for him. The attorney was both Schneider’s attorney and friend, and he cried upon hearing the tape because it was so damning. The attorney commented that it would be hard to go to trial with this evidence. Schneider was arraigned and released on bail. I subsequently testified before the grand jury about the bribe and the rest of the case.

The Brooklyn DA’s office held a press conference to announce the bribery arrest. The press conference was a spectacle. Several of the frozen hams were brought into the conference room where the press conference was being held. They were now defrosted and in terrible shape. They looked and smelled horrible. The district attorney and New York State commissioner of agriculture and markets told the press of the seizure of the tainted hams, the lab results showing them contaminated and unfit for human consumption, the arrest for bribery, and other information. They hinted that the investigator responsible for this case also broke the Good Humor case, but my name was not mentioned.

Schneider decided to plead guilty rather than go to trial. The selling of tainted meat and bribery would not go over well with a jury and the guilty plea was the right decision. Schneider pleaded guilty to attempted bribery in the second degree, a felony. Since he had no prior arrest record and agreed to the plea and acceptance of responsibility, a recommendation of no jail time was made.

This investigation was a great experience so early in my career. I learned a lot about working undercover, bribes, and being prepared for all contingencies. I also saw firsthand the face of fraud.7

7 The name of the individual mentioned in this case study has been changed.
Golden Needles Acupuncture

One of my first cases while serving as a criminal investigator in the San Francisco District Attorney’s Office would prove to be a fraud that had a double wallop on victims. Not only were they defrauded of their money but they also faced health complications from a questionable medical procedure. It was December 1976 when I started an investigation involving a San Francisco acupuncturist who represented himself as a doctor and used an unorthodox treatment method of golden needle acupuncture. He treated patients by permanently inserting gold metal slivers into their bodies.

He claimed that the metal slivers were made of gold, and as a result had special healing powers. The allegations were that the acupuncturist practiced medicine without a license and committed grand theft by false pretenses by advertising in local newspapers that his gold needle acupuncture methods could cure diabetes, strokes, kidney failure, narcotic addiction, Parkinson’s disease, and a host of other afflictions and illnesses. The victims falsely believed the fraudster was a medical doctor who was experienced, competent, and a licensed practitioner of acupuncture.

The case began with the receipt of a victim’s letter of complaint in November 1976. The complaint spells out in sickening detail what she encountered during her visit to the acupuncturist:

*I went to Dr. Kwon on November 12, 1976. He pretended not to understand and worked through a clerk interpreter who in turn told me that the doctor said I should have the gold needle treatment. I’ve had acupuncture several years before from a regular medical doctor, so I assumed that it meant he would use a gold needle instead of the regular steel needle for treatment. No other explanation was given me, and I was placed on the treatment table.

The clerk said that Dr. Kwon wanted to use 20 gold needles at $10.00 per needle for a total of $200.00. I told her to tell him I could not afford $200.00 and I would pay him for the consultation and leave. She protested that I needed the treatment and after she talked back and forth to the doctor in a foreign language, she asked me what I could afford. I said $20.00. She said the doctor would proceed. He injected what felt like a needle in one place on the upper thigh of each leg. Three punctures were made into each knee, one puncture into each calf, several punctures into each ankle and two or three punctures into each foot.

Next I was given a form stating that I released Dr. Kwon from any legal responsibility and would not require him to remove the gold needles or ask him to treat any problems associated with them. It was then that I realized that needles had been placed in my body to stay. I was upset and asked why they had not advised me that gold needles had been placed in my body to stay, and I stated I would never have given my consent had I known. I refused to sign the legal release form. Dr. Kwon became upset and gave the $20.00 check back and told me to go.

My private physician x-rayed my legs on November 15, 1976 and confirmed that small metal slivers are actually in my legs. He stated we would have to wait and see if they did me any harm, because it would be impossible to remove them without extensive and probably injurious surgery.*

My investigation found other victims, including a woman who went for treatment for minor paralysis and weakness in her right arm and in her legs. Needles were inserted in her body using a hypodermic syringe. She reported a great deal of harmful side effects from the golden needle treatment including abdominal pain and bruising, loss of appetite, and fatigue. The acupuncturist told her that the pain and side effects were normal and harmless and that she should not see another doctor about this. This victim further alleged that the acupuncturist threatened her with serious physical injury if she tried to sue or complain about him. There was no improvement in her physical condition as a result of the golden needle
treatment. Other victims, both male and female, were also treated with the permanent insertion of needles into their sex organs to allegedly cure a variety of ailments.

My investigation determined that the acupunctureist was never licensed by the California Board of Medical Quality Assurance as a doctor, and never licensed as an acupuncturist. I found additional patients of Dr. Kwon who had similar experiences as the initial victim. The acupunctureist was arrested in July 1977 and charged with numerous felony and misdemeanor counts related to practicing medicine without a license and operating under false pretenses. He subsequently entered into a plea bargain with the DA’s office and pleaded guilty to six counts of practicing medicine without a license and four counts of false advertising.

In February 1978, he was sentenced to six months in county jail, but that was suspended on the condition that he complete 14 days in jail, 3 years of probation, full monetary restitution to the victims, and 400 hours of community service. He also agreed not to perform the gold needle type of acupuncture or any other similar treatment involving the placement of metal wire or needles permanently beneath the surface of the skin.

This was a fraud that had more than a monetary impact on the victims. The unusual treatment of permanently inserting metal slivers into the body could have had potentially serious threats to the victims’ physical condition. I have no idea what, if any, medical problems the victims encountered over the years but the knowledge of foreign objects in their bodies surely must have weighed on their minds. One can easily argue that the defendant received a figurative slap on the wrist with the sentence.

**Blast from the Past**

In 1983, I was a postal inspector in Brooklyn, New York, where I investigated mail theft, credit card fraud, identity theft, and other financial crimes. My cases focused on individuals who stole U.S. mail from both the postal employees who deliver mail and the mailboxes where they are stored for collection and delivery. Mail thieves rob letter carriers for the potentially valuable letters and parcels they are carrying. These thieves break into house letter boxes, apartment mailboxes, collection boxes, and those green mail storage boxes called relay boxes where letter carriers store mail during their deliveries. Mail thieves know how valuable mail and its contents can be.

I spent a lot of time investigating checks stolen from the mail and then fraudulently negotiated. Checks being sent through the mail for payment of mortgages, credit card statements, or other bills or business payments would be stolen from outgoing mail. Some checks would be altered with new payees and negotiated at banks and other places where checks can be negotiated. U.S. Treasury checks for monthly Social Security or government pension checks were the prime targets of mail thieves. Back in the 1980s, government checks were mostly mailed to recipients whereas today most people receive their benefits via electronic funds transfer. New and renewal credit cards mailed to cardholders were also targets of these criminals. Volume thefts were particularly problematic and they occurred when a thief would break into a collection box and steal its contents or rob a carrier and take all the mail destined for his or her delivery route.

While most mail thefts were committed by people outside the Postal Service, some thefts were made by postal employees. Postal employees who turned to the dark side would steal individual letters or parcels as well as make volume thefts of mail. Usually the criminally minded carrier would steal mail from his route, but sometimes would steal from the routes of other carriers. Whether internal or external thieves, I employed a number of investigative techniques to catch and bring these criminals to justice. One approach was through undercover work and I used it with much success. My usual undercover role would be that of a check fence who was known on the street as someone willing to buy stolen checks at a discount. That was how I met and arrested a postal employee who would never forget me.

Posing as a check fence, or any undercover role for that matter, requires the skills and self-confidence to convince the suspects that you are indeed who you claim to be. I had to have the look and demeanor of

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8 The name of the individual mentioned in this case study has been changed.
a criminal who was in the market for stolen mail and especially Treasury checks. I had enough experience at that point in my career to effectively work undercover and convince criminals I was a criminal too. I always had a back-up team in a covert location or van just in case things went bad, as they sometimes do.

In this particular case, I received some information, from a cooperating defendant I arrested, that a postal carrier was selling stolen Treasury checks. The cooperating defendant was involved in stealing and negotiating checks and had purchased checks from this carrier. The cooperating defendant agreed to introduce me to the carrier as her check fence. A meeting was scheduled and I met with the carrier.

I was wired with a transmitter and a Nagra tape recorder that was hidden on my body. The carrier showed up for the meeting in his postal uniform. After some discussion about the quantity of checks that the carrier had access to and how much I would pay for each one, he produced a large quantity of Treasury checks. We agreed on a price; he turned over the checks to me and I paid him in cash.

The carrier explained that he would say that the checks were stolen from his carrier’s cart while he was delivering mail in an apartment building. After the transaction was completed and I had all the evidence I needed, I identified myself as a U.S. postal inspector. My back-up team moved in and the carrier was arrested. He was shocked to say the least, and we transported him back to our office for processing and arraignment.

The carrier was named Wallace Fortunato. He was brought to federal court, arraigned, and went through the criminal justice system. Since he had no prior arrests, he received no jail time, but he was fired from the Postal Service. That was the last I thought I would hear from him, but that was not to be the case. The date of the arrest was November 1, 1983, and that date would prove to be important.

Fast-forward to early November 1991. I was now working a mail fraud assignment and was in my office in the Hicksville, New York, Post Office. I went to get my daily mail and found an unusual letter. The envelope was addressed to me with a return address of A Blast from the Past and postmarked October 31, 1991. The words Blast from the Past quickly got my attention. The envelope was too thin and small to be a bomb, but something did not seem right. I asked one of the other inspectors in the office to witness me opening the letter.

Inside the envelope was an anniversary greeting card. I carefully opened the card and read what was inside. The right side of the card was preprinted with “An Anniversary wish for a really perfect blend, Happiness, Good Health and Joy right from the beginning to end.” The word An was crossed out and 8th was written over it. A large circle was drawn around all of the words and a diagonal line or backslash was drawn from top to bottom of the circle. This was the universal symbol for no or not. It was clear that the sender was not wishing me a happy anniversary, but what anniversary was he or she referring to?

The left side of the card was all handwritten words in script as follows:

1 Nov 83 GPO Bklyn
Congrats!!
I’ve not forgotten your part in the modern day crucification [sic]
Love
W

That got my attention, and I wanted to quickly find out who was sending me this warning message. It had to be someone I arrested. The November 1, 1983, date was somehow important as was the eighth anniversary. I maintained a log of every person I had arrested throughout my career. The log contained the name, date, and details of each arrest along with the defendant’s photograph. I pulled out my arrest folder and looked to see who I had arrested on November 1, 1983. I had forgotten that I arrested Wallace Fortunato on November 1, 1983, but after seeing his photograph and name, I quickly remembered everything.

This was a threat and something to be taken very seriously. Since the threat was aimed at me, my team conducted the responsive investigation and I stayed on the sidelines. As much as I wanted to con-
front Fortunato and determine why after all these years he was sending me a menacing message, the right thing to do was let someone else do the inquiry. My team located him and interviewed him. We learned that after his arrest, Fortunato’s life took a turn for the worse. He lost his job, his wife, and his future, and he wrongly blamed me for his downfall. He couldn’t stop thinking about me, and when he saw me on television being interviewed about one of my fraud cases, the rage manifested itself into him sending me a message. Add to this that my television interview was shortly before the November 1 anniversary date of his arrest, and that was enough for him to send the card.

While he claimed the card was not intended to be a threat and was only a reminder of his arrest, my team strongly reinforced that this behavior could possibly land him back in court and facing new charges. He said he understood and that was the last I ever heard from him. This episode reinforced for me the importance of vigilance, and to never forget that fraud may result in safety risks for victims and investigators. As a constant reminder, I framed Fortunato’s card and hung it in my office.9

Security Guard Indignity

We expect professionalism and integrity from those entrusted with protecting us and keeping us safe. Whether it’s law enforcement officers or security guards, we don’t expect them to be the source of abuse or agony. Yet that was exactly what happened in a case I investigated where security guards turned bad and became criminals. In the process they literally hurt people and committed fraud as well.

This case involved an alien smuggling scheme carried out in the mid-1980s by security guards entrusted with keeping people who illegally entered the United States in custody and safe until they could be deported to their home countries. Wells Fargo Guard Services (WFGS) had contracted with various airlines at John F. Kennedy International Airport (JFK) to provide guard services in connection with passengers from their respective flights who were denied entry by United States Immigration and Naturalization Service (INS) officials.

Under the applicable statutes and regulations at the time, airlines were required to maintain custody of, and return to their country of origin, any such illegal aliens who entered the United States. Aliens would be held during the pendency of INS administrative proceedings initiated by deportees to challenge their exclusion. The various airlines retained WFGS, in addition, to guard aliens who were traveling through the United States to some foreign country, or in transit without a visa (TROVs).

Between October 1985 and July 1986, over 70 illegal aliens were smuggled into the United States through WFGS’s JFK offices in exchange for hundreds of thousands of dollars in cash payments. In addition, my investigation uncovered numerous instances of abuse of illegal aliens committed by WFGS guards and their associates including overcrowding in hotel rooms, denial of food, thefts, and extortionate demands for sex from female aliens in their custody in exchange for promises of escape. Besides the alien smuggling scheme, the security guards committed fraud by submitting false payment invoices to the airlines for work not performed.

This case involved a joint investigation by the Postal Inspection Service and the INS. I was the case agent for the Postal Inspection Service. As part of the investigation, we conducted numerous interviews of WFGS personnel and others, as well as the review of thousands of documents produced by WFGS and various airlines during the investigation.

Smuggling Conspiracy

Over 20 WFGS employees, including five supervisors and the branch manager participated in the alien smuggling scheme, which involved the use of several different techniques. On some occasions, fraudulent escape reports would be presented to the airlines and the INS to conceal fraudulent releases. At other

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9 The name of the individual mentioned in this case study has been changed.

10 In 2003, the Immigration and Naturalization Service merged with the U.S. Customs Service to create U.S. Immigration and Customs Enforcement and is the principal investigative arm of the U.S. Department of Homeland Security.
times, deportees would be instructed to check in with airline officials, board their outbound flights, and then deplane shortly before takeoff. Still other escapes were arranged, when possible, by instructing the deportee to enter through the front door of the airplane and to leave through the rear door.

As part of the alien smuggling conspiracy, the defendants would permit deportees and TROVs to escape from WFGS custody and illegally enter the United States in exchange for payments varying from two to ten thousand dollars per illegal alien. The defendants would frequently fail to provide food to the deportees while in their custody, and they often crowded deportees into a single hotel room overnight.

On numerous occasions, male guards maintained custody of female deportees during overnight detentions. The guards detained deportees and TROVs against their will at WFGS offices and various hotels while waiting for escape payments. Some guards sexually molested female deportees in exchange for promises of escape.

Under contractual arrangements with the various airlines, WFGS was obligated to provide two guards for each deportee and only female guards for female deportees. No more than one deportee was to be placed in a hotel room for overnight detention. In practice, however, WFGS provided as few as one guard per three deportees and often crowded the guards and more than half a dozen deportees into a single hotel room at hotels in Queens, New York.

The guards would use the hotel room vouchers provided by the airlines to obtain rooms for their own use. Several of the defendants stated that male guards would often take female deportees to rooms paid for with airline vouchers. In one horrific event on April 23, 1986, while the guards were sleeping on the job, a Haitian deportee, who had been held in a crowded room at a hotel in Queens, New York, jumped from the fifth floor to his death.

On other occasions, as many as nine deportees would be locked in a room at WFGS’s JFK offices overnight. The guards often failed to provide food for the deportees and frequently used food vouchers provided by the airlines for themselves. One defendant stated that on several occasions she had observed guards wearing jewelry that she had observed on deportees the previous day.

The defendants mailed false and fraudulent reports to the INS regarding escapes of deportees and TROVs. They recruited people to act as imposters who would travel in the place of released deportees and TROVs. Such imposters misrepresented themselves to the airlines at JFK and used their real identities upon arriving in the foreign country, and for their return to the United States. They often were recruited from the Dominican Republic for illegal entry into the United States through the Wells Fargo JFK International Airport offices. The defendants acted as imposters to impersonate and replace aliens who had been allowed to escape by WFGS. There was even one instance where the guards impersonated an INS official.

One defendant admitted to arranging with others the escapes of over 50 deportees and TROVs who had been in WFGS’s custody between October 1985 and July 1986. As included in the criminal complaint I prepared for the arrest warrant, one defendant stated, “It was common to see girls crying in the office in the morning saying they had had sex with a guard to be set free but they were being deported.” One defendant guard admitted to having sexual intercourse with over a dozen female deportees between December 1985 and July 1986.

I interviewed one deportee whose family paid several WFGS guards $5,000 for her escape. The female deportee told me that she was kept in a hotel in Queens, New York, for several days waiting for her relatives to raise the $5,000. During this time, one of the guards coerced her into have sex with him.
Arrests and Prosecution
On June 8, 1987, the U.S. attorney for the Eastern District of New York filed a criminal complaint that I swore to before a federal magistrate judge charging 27 people with participating in this major illegal alien smuggling conspiracy that operated out of the John F. Kennedy International Airport offices of Wells Fargo Guard Services. Twenty-one of the defendants were employees of the Wells Fargo’s JFK offices who held positions ranging from security guard to branch manager. The filing of the complaint and arrests culminated a 10-month investigation.

The investigation went up the corporate ladder to hold the parent company of WFGS responsible for the fraudulent overbilling aspect of the investigation. On June 7, 1991, the U.S. attorney for the Eastern District of New York issued the following press release detailing the guilty plea of the parent corporation of Wells Fargo Guard Services:

Andrew J. Maloney, United States Attorney for the Eastern District of New York, announced that Baker Protective Services, Inc., (Baker) the parent corporation of Wells Fargo Guard Services (WFGS) will plead guilty today [June 7, 1991] to felony wire fraud, in connection with a scheme by WFGS to defraud commercial airlines operating out of the John F. Kennedy International Airport. Baker also has agreed to pay a $1,000,000 fine.

According to the felony information filed today, between September 1985 and July 1986, various international airlines operating out of JFK Airport retained WFGS to provide guard service for international passengers caught by the U.S. Immigration and Naturalization Service as they attempted to enter the United States without proper visas or other travel documents (deportees). According to the terms of WFGS’s agreements with the airlines, two guards were to be assigned to each deportee, and the deportees were to be guarded for the duration of their stays in the United States. Due to delays such as those caused by the unavailability of outbound flights or challenges to deportation, deportees often remained in the United States for several days or weeks.

According to the information, WFGS failed to provide two guards per detainee, but billed the airlines as if the full complement of guards had been provided. To conceal the fraudulent overbilling, WFGS sent the airlines phony support documents listing the names of WFGS employees who supposedly provided guard services and the number of hours each supposedly worked. In fact, many of the employees listed in the billings were not guards and did not even work at WFGS’s JFK office. Among the airlines defrauded by the scheme were American Airlines, Trans World Airlines, Pan American World Airways, Eastern Airlines, Air Dominicana, British West Indies Airlines, TAP Airlines, Ecuadoriana Airlines, Korean Airlines, and Sabena Airlines.

The overbilling practices at WFGS’s JFK office came to light as a result of an earlier investigation into alien smuggling by guards and other WFGS employees at JFK. In June 1987, 27 WFGS employees and others, including the manager of the JFK office, were charged in connection with a scheme to smuggle detained international passengers into the United States in exchange for cash payments. In all, more than 70 aliens were smuggled into the country during 1985 and 1986, in exchange for payoffs totaling hundreds of thousands of dollars.

According to the earlier complaint, the alien smuggling scheme involved the use of several different techniques. On some occasions, false escapes were reported to conceal the release of deportees. Other times, deportees would be instructed to check in with airline officials, board their flights, then deplane shortly before takeoff. Also, WFGS employees sometimes switched imposters for deportees who had paid cash for their release. The imposters were given free round-trip tickets and cash as payment for their roles.

According to Mr. Maloney, all but one of those charged in the earlier investigations have been convicted; the other is a fugitive.
Next Time Dead

I once investigated an insurance fraud conspiracy involving the ownership of a videotape distributor and videotape rental franchiser. The company’s bookkeeper became a very valuable government informant and witness at trial. In an attempt to dissuade her from cooperating with the government, someone attempted to run down her boyfriend while he was crossing a street, but he was not seriously injured. Within a day, the bookkeeper received an ominous and anonymous warning in the form of a letter mailed to her home. The letters were cut from newspaper clippings and spelled out the following threat:

Friday, October 13, 1989
LUCKY TO BE ALIVE
NEXT TIME DEAD

The threat did not work and the bookkeeper testified at trial. The defendants were convicted and sentenced to prison. Even in fraud cases, the threat of violence can be very real.
Review Questions

1. What inside source revealed criminal activity at Good Humor?
   A. Whistleblower
   B. Check fence
   C. Informant
   D. Information gathered with a search warrant

2. What was crucial in supporting allegations against Good Humor?
   A. Search warrant
   B. Using an informant
   C. Conducting an interview at the manager’s home
   D. Investigator went undercover
**Review Answers**

1. **A. Correct.** A whistleblower is an inside source that revealed criminal activity at Good Humor.
   
   **B. Incorrect.** A check fence is not an inside source that revealed criminal activity at Good Humor. Instead, a check fence is known as a person willing to buy stolen checks at a discount.

   **C. Incorrect.** An informant is not an inside source that revealed criminal activity at Good Humor. Rather, an informant would be used by the investigator to gather information from the suspected fraudster.

   **D. Incorrect.** Information gathered with a search warrant did not reveal criminal activity at Good Humor. Instead, a search warrant was used during the investigation to gather further information.

2. **A. Correct.** Securing a search warrant was crucial in supporting allegations against Good Humor.

   **B. Incorrect.** Using an informant was not crucial in supporting allegations against Good Humor. Rather, informants are valuable assets in many investigations.

   **C. Incorrect.** Conducting an interview at the manager’s home was not crucial in supporting allegations against Good Humor. Instead, conducting an interview at someone’s home can quickly become a dangerous situation.

   **D. Incorrect.** An undercover investigator was not crucial in supporting allegations against Good Humor. Instead, in many scenarios it serves to have the investigator go undercover to meet with the fraudster.
Chapter 7
Arrogance and Recidivism

Learning Objectives

- Identify what often leads to arrests and recidivism
- Recognize a strategy which is effective in minimizing losses due to credit card fraud
- Pinpoint a warning sign of mail-in offer rebate fraud

Introduction

A common denominator that I have found among many fraudsters is arrogance. Combining arrogance with a lack of integrity, responsibility, or conscience, and factoring in huge greed, provides damaging outcomes for the fraudster and victim alike. There have been numerous examples where arrogance resulted in the downfalls of fraudsters. No examples are better than what we witnessed from the corporate frauds involving Enron, WorldCom, Tyco, and others. These corporate scandals involved executives with no integrity, total arrogance, and huge greed, combined with weak boards and accounting firms that failed to fulfill their responsibility for independent auditing.

Corporate fraudsters such as Jeffrey Skilling and Andrew Fastow of Enron, Bernard Ebbers and Scott Sullivan of WorldCom, and Dennis Kozlowski of Tyco exhibited a complete disregard for shareholders and employees with their belief that they could steal whatever they wanted from their respective companies—and get away with it. People who commit fraud never think about the consequences. They believe there are no consequences because they are above the law. They think the corporate piggy bank is theirs to crack open and spend, not caring or understanding that shareholders are the true owners of their companies. These executives forgot who they really worked for and paid the price with convictions, prison, and disgrace.

The significant corporate frauds and resulting prosecutions of responsible corporate executives have provided a new defense posture appropriately named the chutzpah defense. Chutzpah is a Yiddish term meaning unbelievable gall, audacity, arrogance, or utter nerve. Fraudster executives took this word to a new level and applied it to their criminal defense strategies in an attempt to escape criminal convictions and lengthy prison time. Also called the deaf, dumb, and blind defense and the “Hey, I’m just the CEO, what do I know about what’s going on?” defense, this troubling defense strategy was a last-ditch effort to extricate the corporate fraudster from appropriate punishment. This defense strategy usually does not work.

Even upon conviction, fraudster arrogance is still evident. At his sentencing hearing on June 20, 2005, former Adelphia CEO John Rigas, who looted his company of more than $1 billion, told the judge, “In my heart and in my conscience, I’ll go to my grave really and truly believing that I did nothing but try to improve the conditions of my employees.”1 The judge did not buy Rigas’s story and sentenced him to a “life sentence” of 15 years in prison, as Rigas was 80 years old when originally sentenced. In 2008, a federal judge reduced Rigas’s sentence by 3 years, and his new release date is scheduled for 2018.

If You Are Here, You Are Not As Smart As You Think You Are

As I mentioned, a common trait among fraudsters is arrogance. Their self-centeredness that no one is smarter than they are often gives fraudsters a false sense of security that they can get away with anything and everything. They are so used to conning people that they truly believe they can talk, act, or bully their

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way out of any situation. There are even times when such a criminal feels the need to show that arrogance to law enforcement and literally rub his superiority in their faces. We came across such a person when conducting a criminal investigation into an advance fee fraud scheme. Advance fee schemes involve victims paying upfront money to a person or a business in anticipation of receiving something of monetary value in return—usually a loan—but instead getting ripped off and receiving nothing.

In September 1991, one of my team members was conducting an investigation of a scam operation that defrauded victims through advance fees for promised personal loans that were never provided. This scheme used several different business names all operating out of the same address in Westbury, New York. Information on the scam operation was obtained from several sources including a confidential informant (CI), numerous victims, and a review of relevant documents. The CI was employed as a salesperson at the premises from July 1991 through September 1991.

The scheme involved offering loans by way of written advertisements in numerous publications throughout the United States, but outside of New York State. The prospective borrowers were asked to pay a one-time fee of $249 to process loans anywhere from $1,000 to $30,000. According to the CI, the purpose of the scheme was to obtain as many $249 payments as possible, while providing no loans. The CI indicated that the owner of the operation was Bruce Rubenstein, and that at one point Rubenstein stated to sales personnel that not only would he be subject to arrest, but they too could be arrested.

During July, August, and September 1991, sales personnel would routinely explain to customers that they were preapproved for loans and would be called back shortly. The sales personnel would also indicate, if asked, that the $249 fee was fully refundable if the customer proved ineligible for the loan. The sales personnel would then call back within an hour to state that the customer had, in fact, qualified for the loan and that the $249 processing fee would have to be sent to the company via U.S. Express Mail or another private overnight delivery service. Additionally, the sales personnel would state that the payment had to be made by money order and that once the company received the customer’s payment, an application and contract literature would be sent via the U.S. mail.

The investigation was given to my team by a television news program that learned of the fraudulent operation from a source. The producers of the program felt that this would make a great story and decided to infiltrate the scam to obtain firsthand evidence to broadcast. The show even had one of its producers apply for a job and work undercover for a period of time. The undercover salesperson obtained secret videotape recordings of the owner and other people working at the site speaking to victims and talking among themselves. The tapes corroborated the false and misleading statements made to victims to get them to part with their hard-earned money. The undercover salesman also obtained documentary evidence further proving the fraud. The show then decided to provide the evidence to law enforcement for prosecution. The only request from the show’s producers was that they be given exclusive rights to film the raid and arrests for broadcast. We agreed after consulting with the federal prosecutor.

The CI made a covert videotape recording of a conversation with one of the salespeople at the operation. On the tape, the salesperson commented that Rubenstein had instructed personnel that customers could be told virtually anything over the telephone because he was closing down the operation in a few weeks. The videotape depicts sales personnel discussing various false representations being made to customers, including promises that the immediate payment by money order of the $249 loan fee would prevent the imposition of higher interest rates. There were also promises of vacations for customers in return for the payment of the advance fees. At one point on the videotape, a salesperson states that he is a “phone criminal” since he tells customers that he is arranging a loan for them, when in fact he knew that no loan would be forthcoming.

Using the evidence provided by the news program and our investigation, we obtained a search warrant for the premises and an arrest warrant for Rubenstein. We had to hurry because we learned from the postal carrier who delivered mail to the premises that he observed the delivery of a shredding machine. He also observed three employees removing various business documents from file cabinets and shredding them in the office.

We hit the place with our team of federal agents. To our surprise, we found no one present and the place cleaned out. We later learned that Rubenstein became suspicious that law enforcement might be
focusing on him due to all the complaints he was receiving. Apparently, one victim threatened to report them to the feds. Concerned about getting arrested, Rubenstein closed up shop, and all desks and file cabinets were emptied. It wasn’t enough that the arrogant scam artist had gotten wind of our investigation and cleaned the place out. He had to leave us a parting message. Written in black marker on one of the walls was “Hey Feds, Guess What? You’re Too Late. (Expletive deleted) You.”

Now, the message only served to make us more determined to find and arrest him. In fact, his arrogance made him sloppy. Although he tried to remove all incriminating documents from the premises, he had not done a good job. We found valuable evidence left behind the file cabinets and in the bottom of desk drawers. Using our network of informants, we quickly located and arrested the fraudster. But when we brought him into our office for processing that would include fingerprinting, photographing, and personal history, we had our own surprise waiting. One of our postal inspectors obtained a large piece of poster board and in large letters wrote “If You Are Here, You Are Not As Smart As You Think You Are.” The inspector placed the sign directly in front of the fingerprinting table so it would be impossible to miss.

When the handcuffed defendant was brought into the processing room and saw the sign, he immediately hung his head and sheepishly admitted that he had been an arrogant fool. Rubenstein quickly pleaded guilty and was sentenced to a term in prison.2

**Arrogance Is Common**

In 2001, during my first stint as a consultant, I was retained by an international conglomerate based in Europe with operations throughout the world to conduct an internal investigation at its agricultural subsidiary in the United States. The allegation was that their U.S.-based officers perpetrated a massive fraud that was concealed from the board of directors, shareholders, and other members of the management team. The European leadership trusted their U.S.-based team to a fault, but the fraudsters had nothing but disdain for them. They felt that they were smarter than their bosses and could do whatever they wanted with impunity, but their arrogance was their undoing.

In starting the investigation, I had to first learn about the subsidiary’s agricultural operation, which involved growing and ginning cotton. Cotton ginning is a machine process that separates cotton fibers from the cotton seeds. The cotton fibers are then used for clothing and other goods. It is a best practice in any investigation to have a good understanding of the client’s business before starting any investigation. In this case, I actually went to a cotton gin in Georgia to observe and learn the ginning process.

My investigation involved a detailed analysis of corporate books and records, financial statements, and other documents as well as numerous interviews that corroborated the allegations. Many of the relevant banking documents had been either destroyed or removed from the corporate offices by the subjects. They destroyed as many of the records as they could, thinking that doing so would derail any investigation of their misconduct. I was able to obtain replacement banking records from the company’s financial institutions and was able to show the fraudulent flow of money out of the company and to the subjects. Working with outside counsel and forensic accountants, we found evidence of fraudulent diversion of funds, conversion of property, money laundering, and other schemes involving millions of dollars.

I then worked with outside counsel to prepare a civil RICO case for filing in U.S. District Court. The civil RICO charges involved mail fraud, wire fraud, bank fraud, money laundering, and other racketeering activity. My prior law enforcement experience in criminal RICO cases as well as mail fraud, wire fraud, bank fraud, and money laundering investigations proved extremely valuable in this engagement. Sadly for the fraudsters, their hubris got the better of them.

**Arrogance and Recidivism Often Go Hand-In-Hand**

Fraudster arrogance and the belief that one will never get caught often leads to arrests and recidivism. Recidivism is defined as a person’s return to criminal behavior, usually after having been prosecuted for

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2 The name of the individual mentioned in this case study has been changed.
previous crimes. I have seen recidivism throughout my career and one example of an arrogant identity thief recidivist stands out.

Identity theft can become an addictive crime for many perpetrators and it can start at an early age. This is true in the case of recidivist identity thief Abraham Abdallah who learned how easy and lucrative the crime was when he was just a teenager. Prior to 2001, most people had never heard of this fraudster unless they were investigating identity theft in New York City, or were one of his many victims. I was a federal agent then and first came across Abdallah in 1985 when he was 17 years old. He had just been arrested for his first credit card fraud and identity theft violation, but it wasn’t to be his last. In fact, he was arrested 25 times during his criminal career.

Abdallah had been very active as an identity thief since the mid-1980s in Brooklyn, New York. Arrest after arrest for identity theft-related crimes did not deter him from further criminal activity. More important, he continually adapted to changing times by embracing technology to expand his identity theft crimes. In 2001, he hit the big time and landed in the worldwide media spotlight when he stole the identities of many of the rich and famous. As a result, Abdallah is as close as one can come to being a poster child for identity theft.

The Beginning of a Serial Identity Thief

Abdallah’s 1985 arrest was for attempting to obtain an individual’s credit report to use for credit card applications. After his arrest, he agreed to assist in the preparation of a training video on preventing identity theft. The video was called Crime of the 80s and was produced by TransUnion Credit Bureau. The training video was to be used to educate law enforcement, the credit card and banking industries, and the public about identity theft and credit card fraud. Abdallah appeared on the video discussing his criminal behavior in general and his involvement in credit card fraud and identity theft in particular.

Abdallah stated on the video that he started doing credit card fraud when he was 16. He described how easy it was to obtain personal information on his victims, and then to steal money from financial institutions. He also stated, “I just need your name” in order to do credit card fraud, and it “all depends on how good your credit is” as to whether he would be successful. That was true then and it is true now. When asked how much money he could make doing this fraud, he stated “a lot.” Although he claimed that he had learned from his first arrest and was now reformed, his promise of going straight was short lived. Abdallah continued his criminal behavior over the years, and his name became well-known to federal agents and detectives as a result of his numerous arrests for identity theft and related crimes. At an early age, he saw how easy it was to perpetrate identity theft and it became his criminal career.

I was a postal inspector in those years and worked mail theft, credit card fraud, and identity theft cases in Brooklyn, New York. As a result of my work in this area, I was asked by TransUnion to also appear on the video to discuss my perspective on the growing problem of identity theft. From my many cases and even more arrests, I could see it was becoming a major problem throughout the country. My concern back then was that the Abdallahs of the world would embrace this crime and overwhelm law enforcement agencies making the Crime of the 80s the crime wave of the future. I didn’t actually meet him at the time, but after seeing him in the video I knew I would never forget him.

It was about three or four years later while I was walking through my office in Brooklyn that I passed the processing area for arrestees. There I saw Abdallah in the custody of two other postal inspectors, and I immediately recognized him. The other inspectors told me that he was under arrest for credit card fraud. Abdallah would obtain bank and credit card statements stolen from the mail and then open mail drops at mail receiving services in the victim names. He would then fraudulently apply for credit cards in the names of people whose mail was stolen. I asked him about his promise of leaving a life of crime behind and all he could do was look at me with a sheepish grin and say, “I guess I forgot about that.” After that chance meeting, I knew we would be hearing much more from Abraham Abdallah.

Abdallah continued in his career of credit card fraud and identity theft. In 1994, Abdallah took over the credit card account belonging to the president and CEO of a large electronics and appliance retailer in the New York metropolitan area. Posing as the executive, Abdallah submitted a change of address request to the credit card issuer. The address was changed to a Mail Boxes, Etc. (now the UPS Store) location in...
New York City where Abdallah rented a mailbox. Once the change of address was made, Abdallah then requested and received a credit line increase.

Thanks to the diligent fraud control department at the bank, losses on the card were minimal, and this criminal activity was reported to the postal inspectors. Abdallah was subsequently located and arrested in December 1995 in the U.S. Virgin Islands. He was eventually extradited to New York City where he pleaded guilty in February 1998 to federal charges of bank fraud, credit card fraud, and wire fraud. Abdallah was sentenced to 32 months in prison followed by three years of supervised release. The few years in prison kept Abdallah out of circulation, but the wheels of fraud were hard at work in his brain.

**Sadly, An Accurate Prediction**

Beginning in September 2000, and continuing into early March 2001, Abdallah, now aided by his brother and others, embarked on the most ambitious scheme of his criminal career. It would land him in the media’s crosshairs for masterminding the largest theft of identities at the time. According to federal authorities, Abdallah devised a scheme to steal approximately $22 million from a variety of wealthy individuals, corporations, and financial institutions. He picked some of his victims from the Forbes list of “The 400 Richest People in America.” Abdallah’s scheme was successful, as he conned banks and brokerage firms into transferring the true account holders’ funds to accounts that he controlled.

Never one to forget his roots in identity theft, Abdallah duped the major credit bureaus, including Experian and Equifax, into providing him with the credit reports of the country’s wealthiest people, using the names of Goldman Sachs and Bear Stearns as if these companies were the ones requesting the credit reports. Once he had this personal information, he cloned his victims’ identities to gain access to their brokerage accounts at Merrill Lynch, Fidelity Investments, and elsewhere. He opened accounts at investment firms using the identities of his rich victims. He posed as a CEO of a major corporation and attempted to liquidate a large amount of money from a U.S. account and transfer it out of the country. As part of the scheme, a $30 check was altered to read $6.5 million for deposit in an account fraudulently opened in the name of a president of a large corporation.

During the time of this scheme, he held a day job as an unobtrusive busboy. But that was just a cover for his move to the big time. He used sophisticated Web-enabled cell phones, virtual voicemail, e-mail accounts, and computers at public libraries to avoid detection. He rented a mail drop in Manhattan in the name of Microsoft cofounder Paul Allen. “What this guy was doing was setting up mailboxes all over the place,” said a U.S. postal inspector involved in the investigation. 3 He also returned to the tried and true method of identity theft by stealing mail with personal information.

The crime spree was detected when Siebel Systems reported to the New York Police Department that someone had sent an e-mail requesting a wire transfer of $10 million from Siebel founder Thomas Siebel’s Merrill Lynch account to an account that Abdallah had set up. Law enforcement was on Abdallah’s trail for six months before arresting him in a sting operation in Brooklyn. He had ordered equipment to clone credit cards with stolen account information. The police and federal agents were waiting for Abdallah to pick up the equipment at a mail drop, and when his accomplice showed up instead, they followed him. The accomplice eventually led them to Abdallah, and he was arrested on March 7, 2001. This high school dropout had finally gained infamy but not fortune.

In his possession at the time of his arrest was a copy of the October 5, 2000, issue of Forbes with the article titled “The 400 Richest People in America.” He had handwritten notes, including the Social Security numbers, addresses, investment account numbers, and other personal information, on many of the individuals in the article, such as Steven Spielberg, Ted Turner, Warren Buffett, Oprah Winfrey, Paul Allen, Sumner Redstone, Michael Eisner, and scores of others. He had over 800 fraudulent credit cards and tens of thousands of blank credit cards, all waiting to be cloned for identity theft. He also had lists containing credit card numbers and other data on hundreds of individuals, as well as seven handwritten steps on how to commit identity theft.

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On October 3, 2002, Abdallah pleaded guilty in federal court to numerous counts of mail and wire fraud. He was subsequently sentenced to 10 years and 10 months in prison. Abdallah’s criminal career included 11 arrests by the New York Police Department and another 14 by federal law enforcement for credit card fraud, bank fraud, mail fraud, and other crimes. Postal inspectors alone arrested him four times since 1986 for mail fraud and related crimes alone. “I wish I could say that this was all about money—then I’d have a reason to explain why I’ve ruined my life;” stated Abdallah at his pleading.4

Abdallah has been a con artist his entire adult life. He conned victims and he also conned judges. At his February 1998 sentencing for stealing almost $100,000 using fraudulent credit cards, he begged for mercy. “I won’t let you down by reappearing before you in the future,” he promised the federal judge.5 His silver tongue obviously worked its magic as the judge sentenced Abdallah to a very lenient two-and-a-half-year prison sentence. As soon as he got out of jail in 2000, he went right back to what he did best—stealing identities.6

**Arrogance and Rebate Fraud**

Rebate fraud is a crime whereby the primary intention of scammers is to defraud the various product manufacturers like Procter & Gamble and Colgate-Palmolive as well as the fulfillment houses. These individuals like to call themselves rebaters and many believe that they are not committing a crime, just helping themselves to available money. It is believed that upwards of 200,000 people are actively involved in rebate fraud, costing the rebate industry approximately $500 million in fraud annually. These fraudsters make multiple submissions using fictitious names and addresses. They steal and trade rebate forms and use computers to counterfeit them; they produce phony cash register receipts and circumvent the one per household rule.

To facilitate the fraud, these fraudsters sometimes pay people to steal proofs of purchase from products in stores and to obtain proofs of purchase from dumpsters at retail establishments. Some have a network of suppliers throughout the country who sell them blank rebate coupons and proofs of purchase through the mail. They also produce fake cash register tapes, either by actually purchasing cash registers or using computer programs to generate these receipts. Some rebate fraudsters offer advice on how to circumvent rebate rules and sell “complete deals.” Complete deals are packages of rebate coupons, cash register receipts, and proofs of purchase which are sold for less than the actual rebate amount. The rebater can then submit these complete deals to the manufacturers as if they actually purchased the product, and receive the full amount of the rebate. Some rebaters host coupon conventions where rebate materials are bought, sold, and traded.

How serious is this problem? Let’s look at the case of a homemaker in Norcross, Georgia. Between December 1990 and March 1993, she conducted a large scale rebate fraud scheme. To facilitate the fraud, she paid people to steal proofs of purchase from products in stores and to obtain proofs of purchase from garbage dumpsters behind those stores. This practice is commonly called dumpster diving. The rebate fraudster also had a network of suppliers throughout the country who sold her proofs of purchase. She produced fake cash register tapes and submitted them with rebate requests to manufacturers and clearing houses. She also sold these fake cash register receipts to others, and rented 10 post office boxes using various aliases to facilitate this fraud.

In 1991, she began to publish a catalog where she offered to purchase and sell rebate materials for numerous products. The catalog also provided advice on how to circumvent rebate rules. She sold complete deals for 50 percent of the manufacturer’s value. She also sold rebate request forms for 10 percent of the rebate amount, and hosted coupon conventions. This fraudster had 8 employees and worked 17-hour days, and it was estimated that she made approximately $700,000 in this scheme.

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She was indicted on charges of mail fraud and was convicted after a jury trial on December 7, 1993. On February 24, 1994, she was sentenced to 21 months in prison and 2 years of supervised release. In addition, through civil forfeiture, the government forfeited her home, car, and bank accounts.

The warning signs of mail-in offer rebate fraud include:

- Similar handwriting
- Similar address labels
- Similar postmarks
- Similar-size envelopes
- Computer-generated envelopes and labels
- Extensive use of post office boxes
- Same or similar names in batches
- Same or similar addresses in adjoining ZIP codes
- Addresses with suite numbers (may indicate mail receiving agencies)
- Suspicious-looking cash register receipts

Making It a True Federal Case

Here is an example of a rebate fraud case I worked on when I was a federal agent that took on a life of its own. This case came to my attention from a bank teller at a financial institution on Long Island, New York. She noticed numerous deposits of rebate checks, in many different names, by a woman who had accounts at the bank. She felt something was wrong, even though other tellers at the bank told her that this woman had been depositing these rebate checks at the bank for years. But this teller, who was very well-trained, still felt she needed to report this to law enforcement, which she did.

Now, if any one of us walked into a bank with 50 treasury checks in 50 different names and tried to deposit them, most likely we would be quickly questioned and probably arrested. But unfortunately, this was not the case with rebate checks. The investigation revealed that this woman, her husband, and two daughters were actively involved in large-scale rebate fraud. Betsy McGuire and her home address on Long Island were identified as the hub of this fraudulent activity. McGuire and her network of relatives and acquaintances used 30 addresses in New York, New Jersey, California, Florida, Pennsylvania, and Massachusetts to receive rebate checks in more than 500 different names. This scheme had been going on for at least five years.

Besides her residence, McGuire used the addresses of her daughter and son-in-law in New York, another daughter, a chiropractic student in California, her parents in Florida and New York, her brother in New York, her father-in-law and sister-in-law in New York, her son-in-law’s parents in New York, and many others. One of the addresses used to receive fraudulent rebate checks was the law office of her son-in-law. Besides using numerous aliases, she used variations of her name and variations of her address in an attempt to evade detection. She was also quite brazen. She used names like L. Crook, L.Lupo, C. Snake, and C. Worm.

I decided to tackle this investigation using the task force approach. Joining my investigation was the Internal Revenue Service–Criminal Investigation Division. They have jurisdiction in cases involving tax evasion, and clearly people who commit frauds do not declare their criminal proceeds on their income tax forms. Besides the added manpower and resources of another agency, there is an emotional effect, because the IRS creates more fear and concern than any other federal agency.

The victim manufacturers included Procter & Gamble, Colgate Palmolive, Kraft, Gillette, Johnson & Johnson, Chesebrough-Ponds, Warner Lambert, Smithkline Beecham, and others. The victim fulfillment houses included Young America, Promotion Fulfillment Corporation, Lee’s Marketing Services, Gage Marketing Group, Harte-Hanks Direct Marketing, Fulfillment Systems, Continental Promotion Group, and others.

On October 5, 1995, a task force of 44 Postal Inspectors and Special Agents from the IRS-CID executed 10 search warrants and made three arrests in this investigation. Nine of the search warrants were
executed on Long Island and one search warrant was executed in California. We arrested Betsy McGuire and her two daughters, and they were each charged with mail fraud.

I would like to tell you that this case had a happy ending, with the defendants realizing the error of their ways, accepting responsibility, pleading guilty, and reforming their lives. Unfortunately, that was not the case. Rather than admit their guilt and plead guilty, two of these defendants became quite bold. Betsy McGuire obtained my home address, and on Thanksgiving Day, she and her daughter paid me a visit. Suffice it to say that she was not there to wish my family and me a happy Thanksgiving. There was an incident in front of my home, in front of my family, and I was hit by the car that McGuire was driving. Subsequently, McGuire and her daughter were arrested and charged with assault on a federal officer. They spent a week in prison before being released on bail.

Now you would think that after two federal arrests, this 50-year-old homemaker with no prior criminal record would get the message. Well, the answer was again no. We learned that Betsy McGuire had been receiving worker’s compensation since 1988 for an alleged injury she sustained at her job at a local supermarket. She supposedly was unable to work due to her injuries, yet she had been working as an office manager and secretary for two chiropractors since 1988. She was being paid off the books while being treated by these chiropractors. In addition, she conspired with these two doctors to fraudulently inflate the number of treatments she received and then split the proceeds she received from the insurance company with them.

In December 1995, she instructed people to obstruct justice, to destroy records, and to lie to the government about this health-care scheme. Since committing crimes while on bail is an additional crime, Betsy McGuire was arrested for a third time in January 1996. She spent even more time in prison before being confined to house arrest and wearing a monitoring bracelet.

McGuire gave new meaning to “making this a federal case.” The crimes now included conspiracy, mail fraud including rebate fraud and insurance fraud, assault on a federal agent, tax evasion, obstruction of justice, and committing crimes while on bail. Finally after all these crimes, McGuire and her family got the message.

In May 1996, defendant Betsy McGuire pleaded guilty to conspiracy to commit mail fraud relating to a rebate fraud scheme and to witness tampering. Her husband pleaded guilty to conspiracy to commit mail fraud relating to a rebate fraud scheme. One daughter pleaded guilty to conspiracy to commit mail fraud relating to a rebate fraud scheme and perjury before the grand jury. All the pleas were made before a U.S. District Court judge in the Eastern District of New York. The other daughter was given a deferred prosecution.

When Betsy McGuire pleaded guilty before the federal judge, she stated that she was present when her daughter’s attorney instructed the daughter to lie before the grand jury. When the daughter pleaded guilty, she admitted that she perjured herself and that her attorney had suborned perjury by instructing her to lie to the grand jury and providing her with a false story to tell. In addition, the defendants admitted that their defense attorney had provided them with my home address. The defense attorney was prosecuted and convicted for his involvement.

In a postscript to this case of rebate fraud and arrogance, we are still seeing rebate fraud. In July 2012, three Arizona women were arrested for their participation in a widespread counterfeiting and forgery operation of fake manufacturers’ coupons. The defendants set up a website to sell the bogus coupons to unsuspecting victims. A search warrant executed at the home of one of the defendants found $25 million in phony but high-quality-looking coupons, and the police seized $2 million in assets. The victim manufacturers included Procter & Gamble.

**Fraudsters Say and Do the Darnedest Things**

Arrogance often causes fraudsters to say and do the darnedest things. Following are some of the hard-to-believe comments made in cases I investigated and managed.

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7 The name of the individual mentioned in this case study has been changed.
Married? Isn’t That a State of Mind?
In an investigation of health-care benefits fraud, an employee of a company tried to include his girlfriend on his medical plan. He falsely claimed they were married and as such she was entitled to his benefits. During the employee’s interview about the fraud, he told the investigator “We were kind of married.” That statement was followed shortly by “We felt like we were married,” “We told her parents we were married,” then “We intended to get married,” and finally “We were not legally married, but we were living as though we were married.”

This employee also said that the benefits office told him that as long as he was planning on getting married he could add his girlfriend to his plan, and then provide proof later. He was on such a roll with his lies that he decided to add a whopper of a false statement. He then said that they went to a church and did their own private ceremony, but no one witnessed it. But that made them married in the eyes of God.

It’s Just Travel and Entertainment Fraud
There are times when you just have to shake your head and wonder how someone in a professional role just does not get it. As a result, one can understand why fraud and abuse is so rampant. In an investigation of an employee who was committing fraud on his travel and entertainment expense reports, the evidence was quite strong. Fake expenses that were never incurred by the employee were submitted as legitimate business expenses, and phony receipts were provided to substantiate the expenses. An investigator discussed the proof with a human resources person to determine the possible disciplinary action, but that person responded that she would have to check the local policy about travel and entertainment submissions before deciding on any disciplinary action. So the question I asked was: Does the local policy condone fraud and abuse? Of course it doesn’t.

It’s All about Performance
During an interview concerning a relocation expense fraud, an employee provided a variety of excuses when asked about his obviously altered receipts including:

- He said he was moving from a sales position to a nonsales role and would have lost a lot of sales commissions. So he inflated his relocation expenses to cover a portion of his lost wages.
- He said his wife told him to get all the money he was due no matter how he did it.
- He said he was too busy making money for the company to check everything he did.
- He argued “I was gonna spend the money anyways. Besides, it’s the cost of performance and doing a good job for the company . . . I ask you to understand, it was all about performance.”

Finally, after confessing, he actually believed he was still going to relocate. He asked if he could just receive a letter of warning or some coaching prior to his upcoming move. He moved all right—right out of the company when he was fired.

Whoops!
A company employee committed fraud while trying to help a friend benefit financially from a change in third-party status. The friend was a vendor employee, but a change to an independent contractor would mean being paid at a much higher hourly rate. There was no business basis for the change in third-party status and doing so would be an embezzlement of company funds. The company employee had the authority, but not the approval, but still decided to accommodate his friend and fraudulently made the change. When the company employee was interviewed as part of the investigation, he said he helped his friend because “she wanted to get more money for the work she was doing.” Don’t we all?

The investigation also uncovered some damning evidence. When the employee’s human resources manager questioned the logic behind the change in vendor status move, he angrily wrote an e-mail to his friend. In the e-mail the employee fumed that the human resources representative was “getting in the way” and he was upset. Unfortunately, when the independent contractor replied to his friend’s rant, he
mistakenly sent the whole e-mail thread to the human resources representative, and the fraud was discovered. Whoops!

**How About a Warning?**
An employee was interviewed as part of an investigation into the theft of confidential company information and using that information to start a competing business. In addition, the employee was found to have repeatedly accessed pornography over the company’s network. After initially denying the allegations and eventually admitting the misconduct, he was asked what he thought should happen to an employee who had done such misdeeds. He responded sheepishly, “A warning?” I disagreed.

**We Don’t Need No Stinking Policy**
I continually stress the critical role of gatekeepers in an organization to both prevent and detect fraud and abuse. When gatekeepers fail to embrace their unique role, an invitation for misconduct may result. We saw the failure of gatekeepers in the corporate scandals involving Enron, WorldCom, Adelphia, and others. Even in small cases, gatekeepers are important. In an investigation of an inappropriate personal loan made to an employee in violation of company policy, a corporate controller of a company subsidiary stated that “We have a policy of not approving any advances. So I suggested an off-the-books treatment via an IOU.”
Chapter 7 – Arrogance and Recidivism

Review Questions

1. What often gives fraudsters a false sense of security that they can get away with crime?
   A. Arrogance
   B. Recidivism
   C. Network of suppliers that provide crucial elements to commit fraud
   D. Access to post office boxes

2. What is recidivism?
   A. Inability to consider consequences of fraudulent behavior
   B. Defense posture meaning unbelievable gall, audacity, arrogance, or utter nerve
   C. A person’s return to criminal behavior, usually after having been prosecuted for previous crimes
   D. Identify theft

3. What is the primary intention of rebate fraud?
   A. Obtain an individual’s credit report to use for credit card applications
   B. Defraud the various product manufactures as well as the fulfillment houses
   C. Falsify marital status to qualify for health-care benefits
   D. Fake traveling expenses

4. What is a “complete deal”?
   A. An individual who returns to criminal behavior after being prosecuted for previous crimes
   B. Method used to commit credit card fraud
   C. Suspicious-looking cash register receipt
   D. Package of rebate coupons, receipts and proofs of purchase sold for less than the actual rebate amounts to rebaters

5. What is a warning sign of mail-in offer rebate fraud?
   A. Diverse postmarks
   B. Various envelope sizes
   C. Computer-generated envelopes and labels
   D. Same or similar addresses located throughout the country

6. Which of the following is critical in every organization to prevent and detect fraud and abuse?
   A. Fraud control department
   B. Postal inspector
   C. Third party vendors
   D. Gatekeeper
Review Answers

1. A. **Correct.** Arrogance often gives fraudsters a false sense of security that they can get away with crime. Their self-centeredness that no one is smarter contributes to their arrest.
   
   B. Incorrect. Recidivism does not give fraudsters a false sense of security that they can get away with crime. Instead, this describes the fraudsters who return to crime after being prosecuted for fraud.
   
   C. Incorrect. A network of suppliers that provide crucial elements to commit fraud does not give fraudsters a false sense of security that they can get away with crime. Instead, fraudsters may have connections in various locations that can assist in executing the fraudulent activity.
   
   D. Incorrect. Access to post office boxes does not give fraudsters a false sense of security that they can get away with crime. Rather, this is a warning sign of mail fraud.

2. A. Incorrect. Recidivism is not an inability to consider consequences of fraudulent behavior. Rather, corporate executives who commit fraud are often too arrogant in their abilities to consider the consequences.
   
   B. Incorrect. Recidivism is not a defense posture meaning unbelievable gall, audacity, arrogance, or utter nerve. Rather, significant corporate frauds and resulting prosecutions of arrogant, responsible corporate executives provided a new defense posture named the chutzpah defense. Chutzpah is Yiddish meaning unbelievable gall, audacity, arrogance, or utter nerve.
   
   C. **Correct.** Recidivism is defined as a person’s return to criminal behavior, usually after having been prosecuted for previous crimes.
   
   D. Incorrect. Recidivism is not defined as identity theft. Instead, identity theft is a type of fraud that often becomes addictive.

3. A. Incorrect. It is not the primary intention of rebate fraud to obtain an individual’s credit report to use for credit card applications. Instead, this is characteristic of identity theft.
   
   B. **Correct.** The primary intention of rebate fraud is to defraud the various product manufactures as well as the fulfillment houses.
   
   C. Incorrect. It is not the primary intention of rebate fraud to falsify marital status to qualify for health-care benefits. Instead, this is an example of a scheme in which the fraudster believes he has the ability to commit a crime without being caught.
   
   D. Incorrect. It is not the primary intention of rebate fraud to fake traveling expenses. Rather, falsifying expense reports is a common type of travel and entertainment fraud.

4. A. Incorrect. A “complete deal” is not an individual who returns to criminal behavior after being prosecuted for previous crimes. Instead, this is known as recidivism.
   
   B. Incorrect. A “complete deal” is not a method used to commit credit card fraud. Instead, fraudsters fill out credit card application using the victim’s name. The victim’s credit determines how successful the fraudster is.
   
   C. Incorrect. A “complete deal” is not a suspicious-looking cash register receipt. Instead, a suspicious receipt is a warning sign of mail-in offer rebate fraud.
   
   D. **Correct.** A “complete deal” is a package of rebate coupons, cash register receipts, and proofs of purchase that are sold for less than the actual rebate amounts to rebaters.

5. A. Incorrect. Diverse postmarks are not a warning sign of mail-in offer rebate fraud. Instead, similar postmarks are a warning sign.
   
   B. Incorrect. Various envelope sizes are not a warning sign of mail-in offer rebate fraud. Rather, similar-size envelopes serve as a warning sign.
C. Correct. Computer-generated envelopes and labels serve as a warning sign of mail-in offer rebate fraud.
D. Incorrect. Same or similar addresses located through the country are not a warning sign of mail-in offer rebate fraud. Rather, same or similar addresses located in adjoining ZIP codes are a warning sign of mail-in offer rebate fraud.

6. A. Incorrect. A fraud control department is not critical in every organization to prevent and detect fraud and abuse. While it may be serving, many organizations do not employ a department strictly dedicated to fraud detection.
B. Incorrect. A postal inspector is not critical in every organization to prevent and detect fraud and abuse. Instead, a postal inspector is hired to investigate mail theft, credit card fraud, and identity theft cases.
C. Incorrect. Third party vendors are not critical in every organization to prevent and detect fraud and abuse. Rather, in some cases third party vendors assist fraudsters in a crime.
D. Correct. The gatekeeper is critical in every organization to prevent and detect fraud and abuse. When gatekeepers fail to embrace their unique role, misconduct may result.
Chapter 8
Informants and Whistleblowers:
The Good, the Bad, and the Ugly

Learning Objectives

- Ascertain the most important information an investigator can gather before working with a confidential informant
- Identify one reason why people become informants
- Discern what classifies an informant as undesirable

Introduction

In previous chapters I have discussed how you can make yourself lucky and good when investigating fraud. I also reinforced the importance of using informants, whistleblowers, and cooperating defendants in your cases. No one knows the faces of fraud better than those people intimately involved in misconduct, whether as willing participants or eyewitnesses to wrongdoing. Experience teaches us that fraud is often uncovered and reported by people with inside knowledge, including employees, vendors, customers, and others. The longtime administrative assistant or bookkeeper who has been with the company for ages may know where all the “bodies are buried” and if given the opportunity will give valuable information to an all-too-willing-to-listen federal agent, prosecutor, or news reporter.

I truly value informants and the information they can provide. Informants have provided me with evidence I would never have been able to find on my own. Many of these informants were defendants I had arrested for various fraud schemes and flipped into cooperating defendants. They provided me with valuable evidence against their co-conspirators as well as reporting other frauds they became aware of. I used informants in undercover capacities and placed them in fraudulent operations to obtain evidence for prosecutions. I used them as witnesses at trials. Informants who fully cooperated and provided truthful information made me very successful as a criminal investigator, and I continue to use informants in my work in the corporate sector and now as a consultant.

As detailed in Chapter 6, my first big case came to me in 1974, from informants who worked at one of the Good Humor Ice Cream Company’s manufacturing plants. The Metergate case in San Francisco in 1978, which involved a conspiracy to steal coins collected from the city’s parking meters, came to our attention from a jilted girlfriend of one of the fraudsters involved in the thefts. This case is profiled in Chapter 13. I had other cases, like the Postal Money Order theft and forgery conspiracy investigation that I detailed in Chapter 5 that came to my attention by a determined anonymous informant who kept providing me more and more evidence. I have made case after case from administrative assistants and bookkeepers who had firsthand knowledge of wrongdoing by their bosses and were more than willing to expose it when given the opportunity.

Informants, whistleblowers, and cooperating defendants helped expose and prosecute corporate fraudsters in some of the biggest business scandals ever seen. WorldCom’s Cynthia Cooper discovered the cooking of the books by the corporate leadership of her company. In the process, she became a respected whistleblower and was recognized by Time magazine as a 2002 Person of the Year for her commitment to disclosing corporate fraud. Later, former WorldCom CFO Scott Sullivan became a cooperating defendant, testifying against former WorldCom CEO Bernard Ebbers. Sullivan was the government’s star witness against Ebbers with firsthand accounts of how he, Ebbers, and others falsified the company’s financial results and misled investors. Ebbers was convicted and sentenced to 25 years in prison.
Chapter 8 – Informants and Whistleblowers: The Good, the Bad, and the Ugly

Former Enron CFO Andrew Fastow broke ranks with his other indicted corporate officers and testified against his fellow defendants. Fastow pleaded guilty and gave riveting testimony at trial that helped convict former Enron chairman Ken Lay and former Enron CEO Jeffrey Skilling. When faced with decades in prison, white collar criminals are more often than not willing to consider cooperating with the government in exchange for leniency at sentencing. In case after case of corporate fraud, including Adelphia, HealthSouth, and numerous others, cooperating defendants, who flipped and provided insider information about crimes, helped convict and send corporate wrongdoers to prison.

Yet, it is not always so simple to just use an informant, whistleblower, or cooperating defendant against fraudsters and expect good results. It has been said that if someone wants information on crimes, it is more likely to come from criminals than from honest citizens. Every defense attorney will attack the credibility of a cooperating defendant, especially one who was originally part of the conspiracy and decided to break from his fellow criminals. The prosecution does not always have the luxury of using witnesses with high moral and ethical standards. Although one would prefer witnesses without “baggage” for the defense to attack, the fact is that prosecutors have to play the cards they are dealt, and that includes using criminals to testify against other criminals. No one else has better knowledge of fraud than fellow fraudsters.

The problem is that informants, whistleblowers, and cooperating defendants often have their own agendas and have been known to lie and obstruct justice while claiming to be helping investigate and prosecute fraud and corruption. Rather than help the case, they sabotage and destroy prosecutions. At times the fault lies with law enforcement officers who fail to detect the warning signs of betrayal by informants or forget the critical differences in the roles they each play. It has been said that we learn more from our mistakes than our successes. As you will find from the case studies in this chapter, the failure to follow the important rules when using and managing informants, whistleblowers, and cooperating defendants will often lead to devastating results both personally and professionally.

Managing Confidential Informants

Remember the opening to Charles Dickens’s *A Tale of Two Cities*: “It was the best of times; it was the worst of times”? That can also be applied to the use of confidential informants in investigations. Commonly called CIs, they can be the best thing that ever happened to an investigator and his or her case, because they can provide information and details only known to criminal insiders. They can advance a fraud investigation, lead to a successful conclusion of the case, and make any investigator look like a superstar. They can also lie and deceive, ruin a fraud examination, and destroy one’s reputation, or worse.

The FBI’s success against organized crime is directly attributable to its ability to turn high-level mobsters into informants. In one of the most significant mob trials on record, when Sammy “the Bull” Gravano made a deal with the government to testify against crime boss John Gotti, the “Teflon Don’s” fate was sealed. The FBI has continued to dismantle organized crime using numerous Mafia turncoats to obtain hundreds of indictments and confessions.

Law enforcement authorities are not the only ones to use CIs. Often private investigators without law enforcement resources utilize CIs to obtain needed information. While there are some distinctions between a CI used by law enforcement and a CI used by a private investigator, the basic rules remain the same. Understanding an informant’s motives for providing information is fundamental when using CIs. Developing and properly managing CIs is an important skill for fraud investigators to learn and use. Even more important is an understanding of the possible consequences of poor management of CIs who have their own agenda, and mitigating that risk.

What Is a Confidential Informant?

A confidential informant is an individual who supplies information with the understanding that his or her identity will normally not be revealed. Law enforcement often defines a CI as a person who, by reason of his or her own familiarity or close association with criminals, regularly supplies information about criminals or criminal activity and works under the direction of a law enforcement officer. It needs to be under-
stood by all parties that there is always the possibility the informant’s testimony will be needed at some point in a court of law, thus compromising his or her confidentiality.

A large percentage of cases are solved through the use of informants. They can assist in all types of investigations. The assistance of an insider in a fraud to detail the scheme and the role of other fraudsters can help to resolve the case quickly. CIs can also warn of a planned crime, assist in the recovery of stolen property, and enable asset forfeiture. They can also be used to lower criminal morale and create distrust among the criminals.

Using a CI is sometimes considered a shortcut approach, but that thought can be misleading. Much work goes into developing, documenting, and managing CIs. The use of a confidential informant involves a highly personal relationship between an investigator and the CI, the purpose of which is to obtain information that would otherwise be difficult or impossible to obtain.

Types of Informants
Sources of information may be anonymous callers, police officers, citizen informants, or others. They usually provide information voluntarily and on a onetime basis. Citizen informants generally provide information as a result of their belief in good citizenship, or because they are either witnesses to or victims of crimes. The courts have long recognized the difference between citizen informants who are witnesses to a particular crime, and CIs who work on an ongoing basis and who may be paid for their work.

Tested informants have provided information that has proven reliable in the past. These are usually informants that have been used previously and their information has been independently corroborated. Untested informants have not provided information before, thus corroboration is a key factor before any information can be used. The easiest way for an investigator to damage his case is to rely on unproven information from a CI.

It has been said that if someone wants information on crimes, it is more likely to come from criminals than from honest citizens of high moral character. In 1883, at the murder trial of Frank James, the brother of outlaw Jesse James, prosecutor William H. Wallace explained to the jury why he was using a former member of the James Gang to provide testimony against Frank James. Mr. Wallace stated:

> When men are about to commit a crime, they do not sound a trumpet before them. They do their work in secret and in darkness. Neither when they are forming bands for plunder or death, do they select conscientious, honest citizens. A man contemplating murder would not say, ‘come along and join me in my fiendish task.’ Their work is done when honest, law-abiding men are asleep and beasts creep forth. For this reason, when the state must break up a band of criminals, it must depend upon the assistance of one of their peers in crime to do it. Hence, it is a custom, as old as the law, to pick out from a desperate band one of their own number, and use him as a guide to hunt the others down.  

What was true in 1883 regarding informants is still true now.

Motivation to Be a Confidential Informant: Why Do People Inform?
It is important to determine why a person is willing to act as an informant. What drives the person, and what their motives are to provide information must be considered. This determination is critical in evaluating the information that will be provided. People become informants for the following reasons:

- Revenge
- Jealousy
- Fear of jail/resolution of a criminal charge/working off a case
- Good citizenship/the ordinary citizen who wants to do his civic duty

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- Repentance
- Money
- Elimination of competition
- Eccentrics
- Police buffs

**Development and Proper Use of CIs**

Developing CIs should be a continuous process for any investigator or fraud examiner. You must always be on the lookout for possible informants. Potential CIs may be those with knowledge of persons engaged in fraudulent activities or other crimes. They may have occupations that lend themselves to gathering needed information. Criminals, as a result of their association with other criminals, can often provide detailed information on ongoing crimes.

Opportunities for CI development exist in all facets of an investigator’s work. Any person an investigator comes into contact with in the course of an investigation is a potential informant. Contacts and referrals from law enforcement are another possible source. Administratve assistants and bookkeepers in businesses under investigation should be given primary consideration for CI development, as they usually know the skeletons in the closet. Additional sources include ex-spouses and ex-girlfriends/boyfriends. Remember there is a fine line between love and hate and that can be used to one’s advantage to learn important details about a major fraud scheme.

Potential informants may also be doormen, mail carriers, janitors, security guards, restaurant servers, business merchants, or any other person who can supply useful information. The only limitation on a possible CI is the level of experience and the imagination of the fraud investigator. Proper treatment of defendants, witnesses, and others could result in future informants, and a good relationship with a CI can result in the long-term use of that informant.

A CI is only as good as the information provided, and so it is important to learn if the CI has access to the needed information. Is he or she capable of providing the needed information? Does he or she have the common sense, intelligence, and street smarts needed to reason and correlate information? If the CI will be working with criminals, does the CI have the trust of these criminals? Other factors to consider in recruiting a CI include age, health, and personality traits.

It must also be determined if the person has worked as a CI before. If so, the CI’s past performance must be examined. What is the history and pattern of truth or deceit? Has he or she been reliable and dependable as a CI? While the best indicator of future performance is often past performance, CIs need to be continually monitored and evaluated. Background investigations are critical and must be used to learn everything possible about a potential CI. Just as a fraud investigator would conduct due diligence on the subject of an investigation, the same needs to be done for a CI. A CI’s arrest and conviction history must be obtained and reviewed as well.

An investigator must always prove or disprove all information provided by the CI. An independent corroboration of everything a CI provides will protect all the parties involved. There must be zero tolerance for lies. If an investigator continues to use a CI after it is discovered that he has lied, the entire case can be tainted. Not only will the informant and his credibility be vigorously attacked should he take the stand, but the case agent and handler of the CI will also be attacked. In fact, it could be argued that the supervisor of the CI is at fault since that person is a trained law enforcement officer or fraud investigator and is responsible for the actions of the CI.

CIs need to understand that they cannot break any laws while acting as an informant. Informants must understand what entrapment is and that they are prohibited from entrapping any individual during the course of an investigation. CIs must understand that they are not to use drugs and that they are not law enforcement officers. All too often, a CI will mistakenly believe that he can do anything while acting as an informant. For example, in February 2002, a key drug informant for the Dallas Police Department was indicted for misrepresenting himself as a U.S. citizen while applying for a Social Security card. In addition, the drugs seized as a result of this undercover work were found to contain mostly ground drywall
and flour and only trace amounts of illicit substances. Subsequently, the cases made against 50 defendants were dismissed.

In a more recent case, the FBI was embarrassed over its handling of a cooperating defendant in a high profile corruption prosecution. It was the first time a large scale sting operation was used in a Foreign Corrupt Practices Act investigation. An FBI agent posed as the fictitious defense minister of the African country of Gabon, who was allegedly taking bribes in exchange for awarding government contracts to military and law enforcement suppliers. The cooperating defendant, Richard Bistrong, was the intermediary between the undercover FBI agent and the military and law enforcement suppliers. It was called the SHOT Show Case after the Shooting, Hunting, Outdoor Trade Show (SHOT Show) held annually in Las Vegas where 20 of the 22 defendants were arrested in the case takedown.

While the case initially seemed to be a huge success for the FBI, everything went downhill during trial. Defense attorney Eric Bruce in court papers filed on May 12, 2011, argued that the “prosecution is built entirely around an irredeemably corrupt con man, Richard Bistrong, and that, by mishandling him and by other misconduct, the government allowed Bistrong to contaminate every aspect of the operation.”2 The defense attorneys claimed that the FBI agents on the case broke internal rules when dealing with the cooperating informants, including failing to record all of the conversations between the defendants and Bistrong.

Defense attorneys requested and obtained text messages between the agents and Bistrong, and it proved to be the undoing of the prosecution. The text messages revealed that the FBI agents and the informant joked about sex, booty calls, prostitutes, and made vulgar and off-color comments and insinuations. “Defense attorneys used the questionable messages to savage the credibility and professionalism of FBI agents, who not only seemed to share their informant’s offensive sense of humor but also appeared to like him.”3 On February 21, 2012, the federal judge on the case dismissed the prosecution as well as the remaining indictments that were yet to come to trial.

In many cases, the CI may be paid for his or her work as an informant. Monetary gain is frequently a motivating factor in obtaining the services of a CI. If payments are to be made, certain guidelines need to be followed. Since most payments will usually be in the form of cash, receipts must be obtained. Receipts should be signed by both the handler and the CI and witnessed by another investigator. This will provide documentation as to the amounts actually paid and the purpose of the payment. Payments may later become an issue if the case ends up in court and the CI testifies. CIs should be told that all payments must be claimed on their tax returns.

When managing informants, a file should be maintained of all pertinent information including: personal data, results of the background investigation, details of meetings with the CI, information provided by the CI, payments made to the CI, evaluations of the CI’s work, and any other related details. Contact information such as home address, telephone number, and mobile phone may need to be updated on a regular basis.

Protection of a CI is a constant consideration. While most of the work a CI will perform in a fraud case may not result in the potential for danger, the handler must always be aware of possible risk factors. The identity of a CI should be protected as much as possible. To preserve the CI’s secrecy, written reports should not identify the CI by name but should instead use a code. Meetings with the CI should not be held in an investigator’s office but rather in a location where a connection will not readily be made. Depending on the nature of the information, make sure that the CI knows that there is a possibility that testimony

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may be needed at some point. This may determine what the CI will continue to do for the investigator. Safety should always be an overriding consideration.

Assessment of CIs

The investigator needs to continually assess the CI. Many of the skills that an experienced investigator has developed can be used to assess an informant’s work. They include interviewing, reading body language for truth versus deception, and evaluating information. Control is vital in handling CIs as is the need for continuous testing of the information the CI provides. If state law allows, consider using a body transmitter and/or recording device when a CI participates in meetings with subjects of the investigation. A voice or video recording can provide an accurate record of what was said in an undercover meeting. It corroborates the CI and improves reliability. It also keeps the CI honest and protects the fraud investigator. Conversely, the fraud investigator may hear or see something that will alert him that the CI is not being truthful.

Supervisory oversight of the handler and the informant is also important. Investigators using the same CI for a long period of time can lose objectivity and not see developing problems. When a CI’s credibility and reliability come into question and they cannot be independently resolved, a polygraph should be considered. A CI should be deactivated and classified as undesirable for any of the following reasons:

- Acting in a way that endangered his life, the life of the investigator, or anyone else associated with the investigation.
- Lying while under oath or not.
- Providing false information.
- Omitting pertinent facts and details central to the investigation.
- Engaging in criminal activities while acting as a CI.
- Inability to act in an informant capacity.

Avoiding the Common Pitfalls

Investigators must always follow the proper procedures in managing informants and operate within these guidelines:

- Never lose objectivity. An investigator’s hunger for information can blind one from seeing the true nature of the CI.
- Remember that some CIs will say anything they believe the investigator wants to hear. The information may have no basis in truth.
- Remember that all information must be tested for reliability and corroboration before being used.
- At the outset, make it clear what the CI is and is not allowed to do.
- Don’t make promises to the CI that cannot be kept.
- Don’t lie to the CI.
- Don’t let the CI engage in illegal activities.
- Immediately discontinue the use of an unreliable CI.
- The investigator always controls the investigation and the CI, not the other way around.
- Always maintain a professional relationship with the CI.
- Never fall in love with your CI, either figuratively or literally. It can and has happened with disastrous results.
- Beware of personal entanglements that can easily happen.
- Never borrow money from or lend money to a CI.
- Never socialize with them.
- Never invite them to your home or have them meet your family.
- Never discuss other cases or other informants in the presence of your CI.
- Don’t meet informants of the opposite sex alone.
- Remember that your CI may be secretly taping you. Always remember to guard what you say to them as they might repeat it on the witness stand.
• Document all payments made to CIs.
• Do not overpay CIs. Make them earn any payments. Remember, all payments will be scrutinized if the case ends up in court.
• Remember that a bad informant may permanently damage your credibility and reputation.
• Always use good common sense and judgment when dealing with CIs.

Informants Gone Bad

It is not uncommon to have informants go bad. Standard operating procedure with all informants is to strongly communicate from the start that the first rule of being an informant is to always tell the truth and not hold any information back. I used to tell my informants that the truth is like being pregnant. Just like one cannot be almost pregnant, providing information is the same. Either you are pregnant or you are not. Either you provide all the information and knowledge you have or you are useless as an informant. While the great majority of my informants were completely open about their criminal involvement and knowledge of wrongdoing, there were some who decided to hold back certain critical information.

One such example was an insurance fraudster I arrested for staging and inflating property claims. He was a public adjuster and represented the interests of insureds against insurance companies. He had been involved in hundreds of fraudulent insurance claims over the years and I was able to convince him to cooperate. When we first entered into a cooperation agreement with him, the federal prosecutor and I stressed over and over the need to be fully truthful with us and to provide all knowledge that he had on fraudulent insurance claims, the people involved in those claims, as well as any other knowledge of fraud and wrongdoing. We emphasized that he needed to hold nothing back in order to comply with the cooperation requirements; that included any knowledge about friends and family he might have. This defendant agreed to tell us everything.

During our debriefing session, this now cooperating informant provided specific details on the hundreds of fraudulent insurance claims he was involved in. He reviewed the insurance files with us pointing out details and information on the other people involved. His list of co-conspirators over the years went on page after page. I continually reinforced that he needed to hold nothing back and always tell us everything. I reminded him that he may remember things as we worked together and to let us know when he had recollections of information. He always agreed that he would be 100 percent truthful and fully cooperative.

We decided to use this informant in an undercover capacity to obtain further evidence on some of his co-conspirators. As a public adjuster, he maintained an office we could use for the undercover meetings. We set up hidden cameras and recording devices in his office and monitored the meetings he had with other suspects. The informant gave us permission to place the electronic monitoring devices and agreed to assist us as part of his cooperation. In almost every instance we knew in advance who our informant would be meeting with, so we could prepare questions for the informant. The undercover operation was working well and we obtained valuable videos and audio recordings where suspects admitted their involvement in insurance fraud.

One day while we were monitoring a meeting that was about to occur, an unexpected person walked into the public adjuster’s office and started to discuss something. Our informant was clearly surprised that this person had come to his office unannounced. We could see that from the video and hear it in his voice via the transmitter we secreted in his office. Our informant jumped up from his desk, grabbed the visitor by the arm, and briskly walked him out of his office and out of our viewing and hearing range. I remember looking at my partner when this happened and saying this was strange. It was clear to me that our informant did not want us to hear what the visitor was about to say. This was a disturbing turn of events and in violation of our agreement for the informant to always tell us everything.

When we were able to speak to the informant about what had just happened, he said the person was a close friend and had a personal matter to discuss. The informant felt it was inappropriate to discuss this private issue on tape and that is why he walked the person out of his office. I asked who this person was. I could see that the informant hesitated but he eventually provided the person’s name. I quickly recognized
the name as another public adjuster we had suspicions about, but this public adjuster was not one of the
names provided by the informant as someone he knew was involved in insurance fraud.

I told the informant that I knew who his friend was and I asked if the conversation the two had out of
our hearing and recording range had anything at all to do with insurance fraud or our investigation. The
informant said it did not and that as far as he knew, this particular public adjuster was not involved in
fraud. I did not believe my informant but I could not prove he was lying. I needed to know for sure as an
unreliable informant is a recipe for prosecution disaster.

I decided to employ the old axiom: to set a thief to catch a thief. In this particular investigation, I had
a stable of informants who did not know that each other was an informant. One of my informants, who I
had good confidence in, was close to this other informant. My trusted informant was an insured who had
committed insurance fraud but no one knew he had been quietly prosecuted and was cooperating with the
government. I asked this trusted informant to let me know if he heard anything from the public adjuster I
was concerned about that could be helpful to me. In short order my trusted informant had a conversation
with the other informant who related that he was cooperating with the government but was holding back
information on his friends. He said that he had provided so much information that the government would
never know he had not told them everything. He wrongly believed that he could hold back some informa-
tion and get away with it.

I wired up my trusted informant to get this new information on tape. In a follow-up conversation, the
informant in question repeated that he was holding back information and discussed the incident at his
office where his friend came in unexpectedly and almost started talking about an insurance fraud they
were both involved in. Using this information, we confronted the informant in question with his attorney
present. He admitted that he was holding back certain information and he now knew how wrong he had
been to do that. He started crying and begged for mercy for us to give him one more chance, but that was
not to be.

I always made it clear to my informants that they would not have a second chance to be totally truth-
ful. You are truthful or you are not.

This informant was not truthful and we tore up his cooperation agreement. Months of investigative
work was lost because we could no longer use this deceitful person as a government witness. We made
sure to let the sentencing judge know that he lied to us and how it impacted our investigation. The judge
sentenced him to a prison term rather than the possible probation or shortened jail sentence he would have
received for full and truthful cooperation.

**Falling In Love with an Informant**

Law enforcement officers are repeatedly trained and told never to get too close to an informant. As much
as that notion is drilled into their heads through training, there are those who fail to remember this re-
quirement. When I was a Postal Inspector in New York in the 1980s, one of our team members was an
exceptional federal agent. His use of informants made him very successful investigating a variety of
crimes including mail theft, credit card fraud, robberies, burglaries, and counterfeiting of Postal Money
Orders. He worked with a group of informants who provided him information on ongoing criminal activi-
ty and the criminals who perpetrated the offenses. He made arrest after arrest and was well-respected by
his peers.

Unbeknownst to his fellow federal agents, this investigator had fallen in love with one of his inform-
ants and they had developed an ongoing relationship. To make matters worse, the informant was an illegal
alien. One day, the investigator learned that his informant girlfriend was about to be deported. Frantically,
he knew he had to do something to stop her deportation and turned to another one of his informants for
help. This other informant was a United States citizen. The investigator confided in this other informant
the situation and requested his assistance. He asked the other informant if he would marry the woman to
help keep her in the country. The marriage would be a sham and the couple would divorce after a suitable
period of time had elapsed. The informant would be paid for his trouble and he agreed.
Whether it was love or something else, this very smart federal agent forgot good common sense, let alone his training. In order for his girlfriend to obtain her green card, she and her new husband would need to meet with U.S. Immigration and Naturalization Service (INS) and undergo a marriage fraud interview. Immigration officers question the husband and wife separately concerning the bona fides of the marriage. Questions are personal in nature and specific enough to determine if this is indeed a legitimate marriage. Their answers are compared to determine if the marriage and the green card application are made in good faith and not fraudulent.

To help the two informants in the sham marriage, the federal agent prepared written instructions for the two informants to follow when sitting down with the INS officers. The written instructions did not help when the two informants were interviewed; INS officers quickly ascertained the marriage fraud and began interrogating the two. Both quickly flipped and gave up the federal agent. He was prosecuted, convicted, and sentenced to prison. It was a sad and unfortunate event. He forgot his training and he suffered the consequences.

Nightmare Informants

The failure to properly supervise and control informants can lead to disaster. It can take years to recover from a headline-grabbing scandal when CIs go bad. The long and proud reputation of the Postal Inspection Service was tarnished by such an incident. This is by no means indicative of how the agency normally operates. I use this example as just that, an example of what can happen when proper procedures are not followed.

In 1992, the Cleveland office of the U.S. Postal Inspection Service conducted a drug sting operation to combat the growing problem of drug use and drug dealing in the Cleveland Post Office. Two postal inspectors conducted the investigation and used a group of six paid informants to work undercover in the post office. While working in the post office, the informants were supposed to identify postal employees selling drugs to their co-workers. Once identified, the informants were supposed to attempt to purchase drugs from the employees. The CIs made numerous purchases of drugs from suspects that resulted in the arrest of 19 postal workers for dealing drugs.

Unfortunately, the 19 defendants were innocent employees who were framed by rogue CIs. This was a case of inexperienced agents blinded by fame and glory who failed to properly supervise the CIs and conduct an appropriate investigation. The deception was first exposed at the trial of one of the defendants. During trial, a tape recording was introduced as evidence that the defendant had sold drugs. It was discovered that the defendant was not the man whose conversation had supposedly been recorded during an alleged drug deal. He was acquitted of all charges. Cleveland prosecutors then began their own investigation into the sting operation.

It was learned that the CIs faked the drug purchases. No drugs were actually purchased by the corrupt informants. To make it appear that drugs were purchased, the CIs gave bags filled with baking soda and only a small amount of cocaine to the postal inspectors. When the CIs were supposed to tape record the drug deals, they taped staged drug transactions to entrap the innocent postal employees and then provided the inspectors with the tapes. The CIs lied to the inspectors about all aspects of the drug deals including falsely identifying the defendants as the drug sellers. The postal inspectors provided buy money to the CIs to purchase drugs. Since no actual drugs were purchased, the CIs pocketed $250,000 in government buy money the postal inspectors provided them.

The postal inspectors violated numerous safeguards when working with CIs. They lost control of the operation and failed to follow standard police procedures. The two inspectors failed to conduct a thorough background investigation on the CIs they employed; they failed to witness and monitor all drug transactions; they didn’t properly review the tapes supposedly made of the drug deals; they didn’t independently verify the identities of the voices heard on the tapes; they didn’t test the purity of the drugs supposedly purchased by the CIs; they didn’t properly investigate the suspects identified by the CIs to determine if there was any other evidence they were involved in drug dealing; and Postal Inspection Service supervisors didn’t see the red flags when so much buy money was spent and CI payments made.
As a result, innocent postal workers had their careers ruined. A Congressional investigation held hearings into this debacle. The Postal Inspection Service temporarily suspended the use of CIs. The CIs were prosecuted and the two postal inspectors were fired.

**A Rogue FBI Agent Strikes a Deal with Two Devils**

In another example of how a fabled, institutional reputation can be tarnished by the improper use of CIs, retired FBI Special Agent John Connolly was indicted on December 22, 1999, on charges of conspiring to arrange payoffs from two notorious gangsters while protecting them from arrest. The indictment charged the former federal agent with condoning and covering up the criminal behavior of the informants he was managing when he worked in the FBI’s Boston office. The indictment involves crimes that took place prior to Connolly’s retirement.

James “Whitey” Bulger and Steven “The Rifleman” Flemmi were legendary Boston gangsters who were known for the cold-blooded killing of rivals, extortion, and control of the rackets in Boston. Bulger and Flemmi are accused of more than 20 murders during their years of crime. Connolly was an FBI agent from 1968 until 1990 when he retired. He was a member of the FBI’s Organized Crime Squad and he decided to enlist the assistance of Bulger and Flemmi to gain evidence against the Italian Mafia in Boston. Connolly registered and managed Bulger and Flemmi as CIs and that’s when the corrupt relationship began. The two informants provided evidence used to arrest top members of the Italian Mafia.

The relationship between Connolly and Bulger actually began when they were both growing up in a Boston neighborhood. When Connolly was assigned to the Boston FBI years later, the relationship flourished. While cooperating with the FBI, the two CIs were free to continue their extensive criminal enterprise. Although other law enforcement agencies began investigations of the two, no cases were ever successfully prosecuted. They were always able to learn of any police investigations and evade them.

Connolly was accused of compromising court-authorized wire-tap investigations, alerting the CIs about pending indictments so they could flee, falsifying FBI documents, and failing to report serious crimes to illegally protect the informants from prosecution. In 2002, Connolly was convicted after trial on charges of racketeering, obstruction of justice, and lying to an FBI agent. In 2008, he was convicted of second degree murder in another trial. Connolly will spend the rest of his life in prison. Flemmi is currently serving a life sentence in prison for 10 murders he committed. Bulger was a fugitive from justice for 16 years until his capture in Santa Monica, California in June 2011. The lesson learned from this tragedy resulted in new guidelines issued by the U.S. Department of Justice on January 8, 2001, for management of CIs.

**Avoid a Failed Investigation**

There is no doubt that certain investigations, including fraud investigations, can benefit from the use of CIs. Informants provide a valuable tool that is often underutilized. The successful use of CIs requires a certain level of skill and experience. Nothing is more important than the appropriate supervision and continuous evaluation of informants. The improper management of informants can leave the fraud investigator open to criticism and a failed investigation, as well as possible legal action and criminal sanctions. Long after the work of a good informant is forgotten, the improper actions of the bad informants will not be forgotten or forgiven.

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Review Questions

1. What is fundamental when choosing a CI?
   A. History of fraudulent activity
   B. Extent of useful, inside knowledge
   C. Understanding an informant’s motives for providing information
   D. Guaranteeing the informant’s identity will remain private

2. What is a common misconception regarding CIs?
   A. Investigators use informants as a shortcut approach
   B. It takes a lot of work to develop, document and manage informants
   C. The use of a confidential informant involves a highly personal relationship between an investigator and the CI
   D. CIs are developed to obtain information that would otherwise be difficult or impossible to obtain

3. Which of the following generally provide information because they are witnesses to or victims of crimes?
   A. Private investigators
   B. Police officers
   C. Citizens
   D. Tested informants

4. What is the easiest way for an investigator to damage his case?
   A. Choosing tested informants
   B. Relying on unproven information from a CI
   C. Choosing CIs with a history of criminal behavior
   D. Investigating anonymous tips

5. Which of the following is recommended as a safety measure when dealing with CIs?
   A. Identifying the CI only in written reports
   B. Holding all meetings with a CI in an investigator’s office
   C. Meeting with a CI in a location where a connection will not readily be made
   D. Keeping the CI’s identity private

6. Which of the following classifies a CI as undesirable?
   A. Acting in a way that endangered his life
   B. Asking for a list of dos and don’ts
   C. Refusal to engage in illegal activities
   D. Asking to have a professional relationship with the investigator

7. Which of the following is standard operating procedure with all informants?
   A. Strongly communicating that they should always tell the truth and not hold any information back
   B. Identifying circumstances in which it is okay to lie
   C. Waiting until they give you a reason to test the information provided
   D. Identifying circumstances where it would be beneficial to omit pertinent facts and details
Chapter 8 – Informants and Whistleblowers: The Good, the Bad, and the Ugly

Review Answers

1. A. Incorrect. An individual’s history of fraudulent activity is not fundamental when choosing a CI. Rather, investigators often choose informants with a history of fraudulent activity because they are most likely to understand the face of fraud.
   B. Incorrect. The extent of useful, inside knowledge is not fundamental when choosing a CI. Instead, fraud is often uncovered and reported by people with inside knowledge, including employees, vendors and customers.
   C. Correct. Understanding an informant’s motives for providing information is fundamental when choosing a CI.
   D. Incorrect. Guaranteeing the informant’s identity will remain private is not fundamental when choosing a CI. Rather, it needs to be understood by all parties that there is always the possibility the informant’s testimony will be needed, thus compromising his or her confidentiality.

2. A. Correct. A common misconception regarding CIs is that investigators use informants as a shortcut approach. This is misleading because of the tremendous amount of work required to develop a CI.
   B. Incorrect. This is not a common misconception. Rather, it takes a lot of work to develop, document and manage informants.
   C. Incorrect. This is not a common misconception. Instead, the use of a confidential informant involves a highly personal relationship between an investigator and the CI
   D. Incorrect. This is not a common misconception. Rather, CIs are developed to obtain information that would otherwise be difficult or impossible to obtain.

3. A. Incorrect. Private investigators do not generally provide information because they are witnesses to or victims of crimes. Instead, private investigators often utilize CIs for the same reasons as those in law enforcement.
   B. Incorrect. Police officers do not generally provide information because they are witnesses to or victims of crimes. Instead, police officers usually provide information voluntarily and on a one-time basis.
   C. Correct. Citizen informants generally provide information because they are witnesses to or victims of crimes.
   D. Incorrect. Tested informants do not generally provide information because they are witnesses to or victims of crimes. Instead, tested informants are individuals who have proven reliable in the past.

4. A. Incorrect. Choosing tested informants is not the easiest way for an investigator to damage his case. Instead, tested informants have proven reliable.
   B. Correct. Relying on unproven information from a CI is the easiest way for an investigator to damage his case.
   C. Incorrect. Choosing CIs with a history of criminal behavior is not the easiest way for an investigator to damage his case. Instead, those with a history of criminal activity often prove the most efficient in detecting fraud.
   D. Incorrect. Investigating anonymous tips is not the easiest way for an investigator to damage his case. Instead, anonymous tips often provide value-added information.
5. A. Incorrect. Identifying the CI only in written reports is not recommended as a safety measure. Instead, to preserve the CI’s secrecy and safety, written reports should not identify the CI by name but should instead use a code.
   B. Incorrect. Holding all meetings with a CI in an investigator’s office is not recommended as a safety measure. Instead, this type of meeting makes the informant vulnerable to being detected.
   C. Correct. Meeting with a CI in a location where a connection will not readily be made is recommended as a safety measure.
   D. Incorrect. Keeping the CI’s identity private is not recommended as a safety measure. Instead, the CI must be told that he may need to testify in a case, thereby revealing his identity.

6. A. Correct. Acting in a way that endangered his life classifies a CI as undesirable.
   B. Incorrect. Asking for a list of dos and don’ts does not classify a CI as undesirable. Instead, providing informants direction is essential in managing informants.
   C. Incorrect. Refusal to engage in illegal activities to detect fraud does not classify a CI as undesirable. Instead, the CI should never engage in illegal activities.
   D. Incorrect. A desire to have a professional relationship with an investigator does not classify a CI as undesirable. Instead, this is a beneficial relationship.

7. A. Correct. Strongly communicating that they should always tell the truth and not hold any information back is standard operating procedure with all informants.
   B. Incorrect. Identifying circumstances in which it is okay to lie is not standard operating procedure with all CIs. Rather, it is never okay to lie.
   C. Incorrect. Waiting until they give you a reason to test the information provided is not standard operating procedure with all informants. Instead, all information must be tested for reliability and corroboration before being used.
   D. Incorrect. Identifying circumstances where it would be beneficial to omit pertinent facts and details is not standard operating procedure with all informants. Rather, they should never omit pertinent facts and details central to the investigation.
Chapter 9
A Tale of Deceitful Pitches and Vendor Kickbacks

Learning Objectives
- Recognize the term used for more experienced salespeople who step in to close the sale
- Identify the sales pitch a reloader would use to contact a new hire taking over the position of his former contact
- Spot a red flag of boiler room vendor kickback schemes

Introduction
I spent many years as a federal agent investigating and prosecuting boiler rooms. Boiler rooms are the dark and evil side of telemarketing, and fraudulent pitches and deception are the mainstays of these operations. The scam artists who work in these operations will say and do anything to make a sale. Boiler room salespersons’ use of the telephone to facilitate their fraudulent pitches and misrepresentations provide them a false sense of safety and security. They often believe that their physical and perceived distance from the victims make them immune from prosecution and accountability. When boiler room scam artists add kickbacks to their repertoire of tricks, even more damage can be done to individual and corporate victims. My investigation of one such fraudulent operation over several years exposed the fraud and evil that we often see in boiler rooms.

American Chemical Industries (ACI) was a boiler room operation that used high-pressure sales tactics, lies, kickbacks, and extortion to sell its products through telephone solicitations. Salespeople at ACI and its related businesses induced purchasing agents and procurement officers of victim companies to purchase chemicals and computer products at grossly inflated prices by sending them kickbacks in the form of cash and merchandise. The cash and other merchandise were referred to as premiums. These kickbacks were sent to the purchasing agents’ homes to avoid detection by the purchasing agents’ employers.

At times, the purchasing agents were extorted to continue purchasing from ACI. This was called the Pandora’s Box Pitch by the salespeople. Purchasing agents were threatened that their employers would be told about the kickbacks they received if they did not place additional orders. This was one of many fraudulent sales pitches used at ACI and its related companies.

The investigation began in 1987 and continued until 1993. Victim companies were located throughout the United States with total fraud losses in the millions of dollars. Thirty-nine individuals were prosecuted including the owners, managers, salespeople, and administrative employees of ACI, as well as various purchasing agents.

History of American Chemical Industries
ACI offered kickbacks via telephone, euphemistically referred to as premiums. These kickbacks were generally offered to the purchasing agents and procurement officers throughout the United States and Canada who were responsible for the purchases of supplies.

ACI had been in business since the late 1970s at various locations in Long Island, New York, and used many different company names. Business names included American Chemical, Source For Computer Supplies, SCS, Inc., Amchem, Regal Computer, Hydrochem, Ltd., Olympic Marketing, and U.S. Supply Depot. The multitude of business names should be a red flag for every fraud investigator. Fraudsters often use a variety of names when operating their schemes to avoid detection. Once one business name is compromised, either by law enforcement detection or complaints from victims, the operation has other names to start using.
The boiler room first operated in Hicksville, New York, and later moved to locations in Westbury and Rosedale, New York. It also had a satellite office in New York City for several years in the mid-1980s. At times, the operation had over 100 employees, including telephone salespeople, managers, collection people, and administrative employees. ACI was one of the biggest boiler rooms in the New York City metropolitan area, generating millions of dollars in fraudulent sales. ACI’s illegal activity resulted in limited law enforcement inquiry, with no prosecutions until it was investigated by the Postal Inspection Service.

**Description of the Fraud Scheme**

ACI used many different business names to trick the victims into believing that they were dealing with several distinct companies, and the company used various post office boxes to further this charade. Telephone salespeople from ACI and its aliases, using a high-pressure telephone sales pitch, called purchasing agents and attempted to sell them computer supplies and industrial maintenance chemicals. The majority of the business conducted at the operation was through telephone orders. Orders were sent to the customers via United Parcel Service (UPS) and other common carriers. Invoices were sent to customers via the U.S. mail, and customers sent in their payments via the mail.

ACI obtained telephone numbers of potential customers, generally businesses, from lead brokers, mailing lists, and other boiler rooms. The salespeople were divided into two categories: openers and reloaders. Openers were generally the new and less experienced salespeople who made the initial calls to customers. Openers would call potential customers who could authorize purchase orders, and would attempt to sell them merchandise. Openers were instructed to tell the customers that the products sold were of high quality, when in reality, they were of no better quality than similar products available elsewhere. Additionally, these products were sold at huge markups of 500 percent or more.

Openers told potential customers that they were being called in response to an inquiry card that either they (the customer) or their company sent to the operation. In most cases, this was untrue. The openers further told the potential customer that as a way of thanking them for their interest (as evidenced by the nonexistent inquiry card), a free gift was being sent to them. This was also a false statement because, in fact, a gift was only sent if the customer made a purchase.

Another version of an opening call occurred when openers told customers that the customer had previously done business with one of their affiliates; that they were entered into a computer for an annual promotion; and that their name came up as one of the top finalists, all of which were false. The salesperson then told the customer that they were guaranteed to receive one of four fabulous prizes including a color television, a microwave oven, $2,000 in cash, and a “once in a lifetime” vacation for two at any one of 12 vacation spots. This was called the Spec 20 Pitch and was supposed to falsely commemorate the twentieth anniversary of the company.

In order to get a prize, a customer had to order merchandise from the operation. When sales were made, customers were asked for their home address so that the prize could be sent there. While a customer was told that he or she was guaranteed to receive one of the four prizes, the only prize ever given was the vacation. The vacation consisted only of a hotel room. Airfare, meals, and other expenses were not included, although customers were told that these items were.

Salespeople at the operation attempted to get the prize sent to the customer’s home because the customer was usually a purchasing agent for a company. Generally, purchasing agents are not allowed to receive gifts in order to purchase merchandise for their employer. Salespeople at ACI knew that once a purchasing agent had received a gift at his residence, this could be used against him in the future to force the purchasing agent to make large orders of overpriced merchandise. It was not uncommon for salespeople at ACI to send out unordered merchandise and then threaten legal action if the purchase invoice for the merchandise was not paid.

Once an initial sale was made by an opener, a reloader would take over to close the sale. Reloaders were more experienced salespeople and received larger commissions. They were allowed to use a variety of pitches provided by the company, but were also allowed to make up their own pitches. Reloaders called the customers to persuade them to make larger purchases. Fraudulent sales pitches are the lifeblood
of telephone scam rooms. Fraudsters use their evil imaginations to come up with outlandish pitches that more often than not work. Reloaders used the following fraudulent pitches:

**In-Transit Pitch:** The reloader called a customer who had made a previous purchase and had received a gift, and asked the customer if he or she had received the last order, especially the premium. The reloader then stated that the other half of the order was being sent out along with another premium. The reloader implied that this was part of the first order, which was untrue. This In-Transit Pitch was repeated as long as the customer continued to make purchases.

**New Person Balance Pitch:** If the reloader learned that the particular purchasing agent with whom he or she had been dealing with had left the company, the reloader would ask for the prior contact’s replacement. The reloader would then falsely represent that the former employee ordered products from ACI before leaving and that the material was now being sent. In many cases, the unordered merchandise was accepted and paid for. This pitch was also called the Back Door Pitch.

**Truck Story:** Purchasing agents were falsely told that one of ACI’s trucks was in the customer’s area and that either the truck had broken down or that the company that originally ordered the merchandise canceled the order. The reloader then told the purchasing agent that ACI would like to deliver the merchandise at a substantial discount along with a gift. No product would be shipped by ACI unless the customer agreed to make a purchase.

**Alaska Pitch:** The reloader falsely represented that he or she was being transferred to Alaska as a career promotion and that he or she could discount some products and award another gift to the purchasing agent. Reloaders would often switch Alaska with another state for variety. This pitch was also called the Goodbye Pitch.

**Anniversary Pitch:** The reloader falsely represented that the operation was celebrating a twentieth, twenty-fifth, or fiftieth anniversary and that some customers in each state were winners of expensive gifts. However, in order to receive the prize, the customer had to order merchandise.

**Handicap Pitch:** The reloader falsely represented that the operation hired handicapped people, thus explaining any billing mistake or unordered merchandise that had already been sent. The salesperson represented that if the boss ever found out that a certain handicapped individual made a mistake with the order, the handicapped individual would lose his or her job. Sympathetic purchasing agents usually accepted this story and paid for the unordered merchandise.

**Heart Attack Pitch:** The reloader would falsely represent to the purchasing agent that the previous ACI salesperson had a heart attack and was in critical condition. The reloader would then state that the heart attack victim did not have adequate health insurance and all the ACI salespeople were donating their commissions that week to help defray the hospital costs. This emotional pitch often worked in getting the purchasing agent to make large orders and, of course, still get the premium delivered to his or her home.

**Death Pitch:** If the Heart Attack Pitch was successful in obtaining an order or orders, the reloader would consider using the Death Pitch as a follow-up. The reloader would falsely represent to the purchasing agent that the previous ACI salesman who had the heart attack and was in critical condition now suffered another severe heart attack and had died. Now all the ACI salespeople were pooling their commissions to provide to the deceased’s family for funeral costs and other expenses.

**Sex Pitch:** This pitch was used primarily by female reloaders to close a sale with a male purchasing agent. The reloader would comment that she had a sister or close friend who happened to reside in the same city as the purchasing agent. The reloader would say that she was planning a trip to visit the sister or friend in the near future, and that it would be great if she and the purchasing agent could get together for a drink or dinner. The reloader would comment that she is single, used to model, and loves to party. You can imagine what was now going through the purchasing agent’s mind. The reloader would add that she was short of cash for the trip and was hoping to
close some more sales to have the money to book the airfare and hotel. If she could just close this sale, she would be well on her way to booking the trip. The purchasing agent thinking that he was in for a good time would usually be more than willing to place an order.

**Urban Renewal Pitch:** The reloader would falsely tell the purchasing agent that ACI was closing down at a particular location because the town was demolishing the building as part of an urban renewal project. Therefore, rather than move all of the merchandise to a new warehouse, the company was offering deep discounts to get rid of it. Of course, a premium would still be sent to the purchasing agent’s home.

**Pandora’s Box Pitch:** If merchandise that was already shipped had not been paid or if the purchasing agent did not want to continue the relationship, the reloader would tell the agent that unless the invoice was paid or additional orders were placed, his or her employers would be told about the kickbacks received at the agent’s home. This is also called the Extortion Pitch.

When the various pitches did not have the desired effect and the customer had questions or objections, the ACI salespeople were ready with responses. ACI had prepared “overcoming objections” sheets that were given to salespersons. For any possible questions or concerns that the customer could have, such as, It’s too expensive; Send me literature first; I want to think about it; or Is it guaranteed, ACI had an answer. If by chance the salesperson did not have an answer, ACI would just hang up and call another potential victim. Samples of the scripts for overcoming customer objections that were found during the execution of search warrants are as follows:

**Send me literature first:** “I can send you literature, but you and I both know literature isn’t going to do the job for you like the product itself. Let me make another suggestion [go to the appropriate sales close pitch].”

**Send me a sample:** “We don’t send samples, but I can send you a small quantity to get started with. Let me make another suggestion [go to the appropriate sales close pitch].”

**It’s too expensive:** “You know the old saying you only get what you pay for, and we send you the very best. Also, my customers keep reordering it, so it must be worth it. Let me make another suggestion [go to the appropriate sales close pitch].”

**I want to think about it:** “What’s to think about? The sooner you receive a small amount and put it to use, the sooner you’ll realize what a fine product we sent you. Let me make another suggestion [go to the appropriate sales close pitch].”

**I have the product on hand:** “I didn’t expect to catch you without material on hand waiting for me to call. That’s why I suggested the small amount to start with. Let me make another suggestion [go to the appropriate sales close pitch].”

**Is it guaranteed:** “I’m looking for future business, so I’m not going to send you something that isn’t the best in the industry. It will do everything I’ve told you it will do, and that’s in writing on the box. Let me make another suggestion [go to the appropriate sales close pitch].”

**Shouldn’t I buy locally:** “You should buy locally. However, suppose one of your vendors lets you down. You need a backup, right? Now let me tell you what I’m going to do for you.”

ACI employed verifiers whose function was to contact purchasing agents after a sale was made by an opener or reloader. The verifier would verify the information of the sales order form including the purchasing agent’s home address. The fraudulent pitch that had been used by the opener or reloader was written on the sales order so that the verifier and anyone else contacting the victim could follow the same false story.

ACI also employed collectors whose function was to call victims who had not paid their invoices and find out why they had not paid. The collector would attempt to get the victims to pay. Often the victims would complain that they had not ordered the merchandise, that they had not received the promised gift,
that the merchandise was of poor quality, or that they had been the victim of fraud. Usually the promise of another large gift or cash to the purchasing agent’s home was enough to overcome these complaints. If that didn’t work, the Pandora’s Box Pitch was used, usually with success.

ACI sold various products such as cleaners, degreasers, solvents, insecticides, weed killers, and computer maintenance sprays and cleaners. While ACI falsely told its victims that they manufactured these products, in reality ACI purchased these products from other legitimate manufacturers and had its own labels placed on them. These products were grossly overpriced. For example, a six-can set of computer cleaning products generally was $7 wholesale but was sold to victims for $299 or more.

Detection and Investigation

My investigation started in December 1987, after I received information about this scheme from a confidential informant. Additional information was developed from other confidential informants, victims of the scheme, and the Better Business Bureau. Upon learning of the allegations of fraud, I had a confidential informant obtain employment, in an undercover capacity, in the boiler room operation to develop corroborating evidence.

Confidential informants can be extremely valuable in identifying and investigating fraud schemes. They are a valuable and potent tool to use in developing evidence against fraudsters. Informants can be especially helpful if they are cooperating defendants who have previously worked in boiler room operations with knowledge of other fraudsters and their operations. I ultimately used many informants in this investigation. For more information on informants and whistleblowers, please refer back to Chapter 8.

The undercover informant worked as a telephone salesperson at the Westbury, New York, premises. He wore a concealed recording device that I provided, and I quickly learned what was going on in the operation. The informant was able to provide me information on the extent of the fraud; the number of employees at the operation; the names of the owners, managers, salespeople and others; the phone aliases that they each used; the pitches used; the kickbacks paid; and much more additional information. There is a huge benefit to having an undercover informant inside a fraudulent operation, and should be considered whenever possible in criminal investigations.

This information along with that developed from other informants, victims, and independent investigations resulted in a search warrant being executed at the Westbury premises of ACI on February 17, 1988. Among the evidence seized from the search were financial records, pitch sheets, commission sheets, personnel records, computer software, customer files, customer complaint letters, sales training manuals, invoices, mailing receipts, and other business books and records. Among the hundreds of written copies of fraudulent pitches found in the operation were the following examples:

**Handicap Pitch**

I’m calling because I want to tell you about a problem we have with your company and I need your help. We hire these 18-year-old handicapped students from the local high school. I have four of them in my office. One of the newer girls took a payment schedule and fed it into the order division and we have more material being shipped than it should. Because of this error and in the case of your company, the material shipped out last Friday to you. Now my boss is a combination of Attila the Hun and Muammar Kadhafy and if he finds out about this goof-up then this nice student program I personally implemented with these handicapped kids will be in serious jeopardy. What I’m saying to you is if you can see your way clear to take these products, I’ll personally get you a beautiful gift to your home address but more importantly, we’ll all feel good about it including the kids. Can you do that for us?

Of note, the author of the pitch wrote the comment “now you are crying” on the pitch sheet, referring to the heart-wrenching effect of the Handicap Pitch.
Alaska Pitch

How are you today? Did you get that notice my company sent you? Well, can you believe it, my company is sending me to Alaska. I am going to be up there for the next 12 months to oversee some contracts with oil people.

Tell me, have you ever been to Alaska? I hear besides the scenery, it gets very lonely up there unless you enjoy fishing. By the way if you receive a package of salmon on dry ice, you'll know who it is from.

I was cleaning out the warehouse this morning and I came across a stereo unit that was supposed to go out to you some time ago. So I brought it over to my shipping department and it's going out to you today. You should receive it in 10 to 14 days. When you receive it, make sure it is in good working condition and don't forget to send in the warranty card.

And by the way, what I did was make you up a small order of our All Purpose Cleaner that will be out to you in about two to three weeks. Now, will that be enough to hold you over until I get back next year? Great!

In reviewing the sales records I seized I found key evidence. The sales records listed the date of sale for each order, the type of pitch used, the name of the salesperson, the total amount of the order, the salesperson’s commission, the type and amount of kickbacks paid to the purchasing agent, and the name of the purchasing agent.

Shortly after the February 1988 search warrant, ACI reopened with its same fraudulent operation. I continued my investigation by obtaining the cooperation of former ACI salespersons, managers, and administrative employees who had left after the February 1988 search. Most of these former employees agreed to plead guilty to various mail fraud counts, and they provided a clearer picture of the operation.

Sal Rizzo was the owner and operator of ACI and its related companies. Tim Ryan was the controller for the various businesses and directed the financial operations. Billy Segal was a manager and collector; Samuel Brown was a manager and verifier; Mel Miller was a manager; and Ricky “the Finisher” Quinn was the top reloader. Quinn was called “the Finisher” for his ability to figuratively hammer victims until they gave in and placed an order.

Review of the seized evidence revealed that the sales order sheets prepared by the salespeople contained a box titled “Home address for birthday and anniversary cards.” ACI claimed that this section was on the sales order form so it could send out greeting cards to customers. In reality, this information was obtained not for the purpose of sending out greeting cards but for sending out the hard premiums and cash. The ACI copy of these sales orders sometimes contained a code to indicate whether the purchasing agent was to receive a hard premium or cash. The sales order sheets also identified the particular pitch that was used by the salesperson.

I learned that ACI had a formula to determine the kind and amount of kickback given to the purchasing agent. The larger the order was, the better the premium. The purchasing agent would receive a hard premium such as a camera or an answering machine for a small order, a stereo or a 19-inch television for a large order, or a VCR or a 27-inch television for an even larger order. For orders over $5,000 cash was given, usually about 10 percent of the order. Only the reloaders could give cash to purchasing agents.

In some cases, in order to hide the existence of a kickback sent to the purchasing agent’s home, the gift would be written by the salesperson on a separate piece of paper. This would be attached to the sales order sheet. This piece of paper would later be destroyed after the gift was sent to the purchasing agent so that no record of the gift existed on the sales order. The cash would be sent to the purchasing agent’s home in a plain white envelope with no return address. Generally, a return receipt form was attached to the letter so ACI knew that the purchasing agent received the kickback. I also learned that when very large sums of cash were to be sent to a purchasing agent, either Rizzo or one of the top reloaders would personally hand deliver it.

Rizzo told my undercover informants that he preferred using cash as kickbacks because it is almost impossible to trace. The old adage that there is no honor among thieves was never truer than in this case.
Rizzo was suspicious that his business partner would pocket some of the cash meant for purchasing agents and he was upset over this. He also said that he inflated shipping freight charges, sometimes as much as 10 times the legitimate cost, to make even more money from sales.

One of my informants learned from a reloader named Nicky Gallo that he sent cash kickbacks to purchasing agents to secure sales. This reloader called the cash “the green.” Gallo made physical threats to one purchasing agent when the agent decided to stop doing business with ACI. The purchasing agent made a tape recording of the threat and complained to local police. Gallo was arrested and convicted for the threats and received probation. For whatever reason, the local police did not comprehend the significance of their evidence and they pursued no further investigation of Gallo or ACI. We did find something related and of interest during the search. In Gallo’s desk we found a cartoon drawing he had made poking fun at this arrest for the threats. Obviously, he thought it was a joke.

We also found the original canceled business checks that the operation used to generate the cash kickbacks. Rizzo would make out checks payable to the salespeople with notes in the reference section such as “advances,” “exchange,” and “travel and entertainment.” The salespeople would cash the checks and return the money to Rizzo for kickback payments. The salespeople who agreed to cooperate told me about this arrangement, and we used this as further evidence of the scheme.

The Continuing Investigation

Rizzo was concerned about a government investigation and told other fraudsters that the postal inspectors, and me in particular, were concentrating on boiler rooms in Nassau and Suffolk counties on Long Island. Rizzo recommended that the boiler rooms move to Queens to avoid law enforcement. The operations would again change their business names.

In the spring of 1989, ACI closed its Westbury, New York, office and moved to smaller quarters in Rosedale, New York. It changed its name to U.S. Supply Depot. The owners wrongly believed that by moving to an adjoining county, the investigation would end. In the fall of 1989, the Postal Inspection Service was able to catch Rizzo and Segal on videotape discussing their fraudulent operation. This was accomplished through the use of a confidential informant who gained the trust of Rizzo and Segal. Rizzo again admitted among other things that he preferred cash kickbacks because they were difficult to trace. Segal discussed the benefits of cash bribes over hard premiums by saying “How many TVs can they use?” They also discussed the various fraudulent pitches used at the operation.

In December 1989, a search warrant was obtained for the Rosedale premises along with arrest warrants for 23 of the owners, managers, salespeople, and administrative employees. Corroborating information from 17 confidential informants was used in the supporting affidavit. These warrants were executed on December 19, 1989, and subsequent days. Immediately, many of those arrested agreed to cooperate with the government and plead guilty to mail fraud charges. Evidence of tax evasion was obtained and the Internal Revenue Service’s Criminal Investigation Division joined the investigation.

I then focused my investigation on the many procurement officers who had defrauded their companies through the acceptance of kickbacks. I had the cooperating ACI salespeople call the procurement officers and engage them in conversations regarding their criminal activity while I recorded them. I also conducted surprise interviews of these purchasing agents to obtain confessions and further details of their fraudulent conduct that I then shared with the victim companies. These purchasing agents were then prosecuted for their criminal activity. In all the cases, the victim companies had no idea that their procurement officers were defrauding them and taking kickbacks. I also shared with these victim companies the red flags I had learned from conducting this investigation, in the hope that this would benefit fraud prevention. The fraud losses to victim companies were in the millions of dollars.

Prosecution

In April 1990, Rizzo, Ryan, Brown, Segal, and five other reloaders were indicted on mail fraud charges. In June and July 1990, most of the remaining managers, salespeople, and administrative employees pleaded guilty to charges of mail fraud in the Eastern District of New York. Many of these defendants
received cooperation agreements from the government. This allowed the sentencing judge to downwardly depart from the Federal Sentencing Guidelines. These defendants received sentences ranging from 5 years of probation to 33 months in prison, while some defendants received periods of home confinement. Fines were ordered on many of the defendants as was restitution depending on their ability to pay.

In July 1990, it was learned that Rizzo and a few loyal employees were continuing to operate by attempting to collect on fraudulent orders not paid. Another search warrant was obtained and executed in August 1990. After this, the operation closed down for good. In August 1991, Rizzo and Ryan were hit with new charges of tax evasion and mail fraud in a superseding indictment. Subsequently, all the remaining defendants with the exception of Rizzo pleaded guilty. Their sentences were similar to those previously sentenced, but a few defendants were again arrested on new crimes they committed.

Rizzo was scheduled to go to trial in February 1992, but shortly before the trial, he agreed to plead guilty to the mail fraud and tax evasion charges. He pleaded guilty on March 5, 1992. Subsequent to his guilty plea, Rizzo, who was in his 70s at the time, became ill with heart disease and diabetes. His sentence was delayed due to his ill health. Early in 1996, the sentencing judge ordered Rizzo to report to a federal medical facility for evaluation. It was subsequently determined that Rizzo could be sentenced. He was sentenced to three years in prison and three years of supervised release.

In addition, 14 of the most criminally involved purchasing agents were prosecuted. They were each charged with mail fraud and pleaded guilty. They were sentenced to terms of probation ranging from 5 years of probation to 27 months in prison. In addition, they received fines ranging from $2,000 to $5,000. They were also ordered to make restitution to their defrauded employers depending on their ability to pay.

One of the purchasing agents, who received cash kickbacks not only from ACI but from other similar boiler room operations as well, sent a letter to the assistant U.S. attorney after receiving notification that he would be prosecuted for his crimes. His letter speaks of anguish and sorrow. He comes across as both victim and perpetrator. He is both the face of fraud and its casualty. He wrote:

> Inspector Biegelman entered the picture in the spring of 1990. I had two conversations with Mr. Biegelman. I once again told my story in regard to my involvement in this alleged scheme. I told of my relief of no longer having these people whom I know as [names of the ACI salespeople he dealt with] in control of my life and my job and of the many times they had implied that they would call my boss if I did not cooperate with them. I was already involved and I knew I would lose my job if they followed through on their threats.

> I can tell you that if there was anything I would or felt I could do to change what took place it would have been to turn these people in and face the consequences as they came. I was scared and still anguish over my stupidity and greed. I also know that I will not rest until I know these people are indeed brought to their justice for the complete demise of a forty-five-year-old career-oriented, basically honest and good-willed person that has already suffered irreparable damage to my career, my family, and my future ability to earn a living. The punishment of society in these matters is swift and unrelenting, but I need to put this behind me and try and salvage what I can.

**Special Circumstances**

While boiler room schemes are quite common, what was unique in this case was the size of the operation (at times over 100 employees), the time frame of the fraud (ACI and its various businesses were in business from the late 1970s), and that they continued to operate even after being searched by federal authorities.

After the arrest of one of the reloaders in December 1989, and as part of the discovery process, he and his attorney were allowed to review the search warrant evidence maintained in my office. While reviewing this seized evidence, defendant Nicky Gallo stuffed some incriminating documents down his pants. After leaving my office, Gallo bragged about doing this. Unfortunately for Gallo, one of those who he
told was an informant of mine. I again arrested Gallo and this time charged him with theft of government property (i.e., the seized documents). The stolen documents were recovered.

During the investigation, a local police agency was investigating Rizzo’s son for involvement in a car theft ring. Wiretaps were obtained, and Rizzo and his son were overheard discussing the ACI investigation. Sal Rizzo incriminated himself on the wiretaps and this evidence was turned over to me. Among the recorded statements that Rizzo made were:

- “I’m going away; you can go to the bank on that.”
- “He’s the one that puts the nail in my coffin.” (Referring to a cooperating salesperson)
- “There’s no way, there’s absolutely no way I’m gonna beat this. My lawyer told me I’m gonna do time.”
- “There’s enough people that have turned.”

Subsequent to the indictments of Rizzo and the other ACI employees, the government filed a motion to disqualify Rizzo’s attorney. The basis of the motion was that the defense attorney was a potential witness in the case, by virtue of his prior representation of important government witnesses in this prosecution. Shortly after the February 1988 search warrant, this attorney instructed many of the ACI employees to no longer send out cash kickbacks and not to send premiums to the purchasing agents’ homes. By making these and other statements, this defense attorney placed himself in the position of a potential witness for the government and as an unsworn witness for Rizzo, thus putting his own credibility in issue.

In addition, prior to the Postal Inspection Service investigation, several local and federal agencies had made inquiries into the operation of ACI. These inquiries usually involved allegations of kickbacks received by purchasing agents. While no prosecutions ever took place, Rizzo had his attorney legally represent the salespeople who were the focus of these law enforcement investigations. Subsequently, these same salespeople became cooperating defendants for the government. Since Rizzo’s attorney represented them and also Rizzo, there was a conflict. This attorney was disqualified by the district court judge assigned the case.

Several of the defendants arrested in this case were later arrested on new charges stemming from similar conduct at other boiler rooms. Among them were Ricky “the Finisher” Quinn, Mel Miller, and others.*

**Fraud Prevention**

Boiler room fraud costs consumers, businesses, and financial institutions billions of dollars in losses every year. The best way to be protected is to recognize the warning signs of fraud. This is where fraud investigators can provide even more value and protection. Fraud investigators should be more than just great investigators. They need to be evangelists of fraud prevention. By knowing and effectively communicating fraud prevention, investigators can be agents of change in stopping fraud.

The red flags of boiler room vendor kickback schemes include:

- Purchases previously made from local vendors are now made from ones out of state.
- The purchasing agent is buying from new vendors, all with different names and addresses but from the same geographic area.
- The purchasing agent’s spending has greatly increased over previous years.
- The purchasing agent is living beyond his or her means.
- Products purchased are not brand names but instead are generic or unknown brands.
- There are complaints about the quality of the products purchased.
- Large numbers of products are stockpiled in the warehouse.

* The names of the individuals mentioned in this case study have been changed.
Prevention of vendor kickback fraud schemes include the need for:

- Separation of duties so that a person who opens a purchase order is not the same person who can approve payments on the purchase order.
- A system of higher-level approval for large purchases.
- A system of competitive bidding for large purchases.
- A company policy requiring local purchases unless specifically approved by higher level personnel.
- An organizational policy forbidding the acceptance of gifts and gratuities.
- An organizational policy to instruct employees on the illegality of accepting kickbacks and the criminal, civil, and personal consequences.
- Frequent onsite inspections of company warehouses and storage areas to determine if large amounts of boiler room purchased products are present.
- A competent internal auditing program to uncover vendor kickback fraud schemes.
Review Questions

1. What are premiums?
   A. Fraudulent pitches
   B. Boiler room salespeople responsible for making the initial contact with a victim
   C. High-pressure sales tactics
   D. Cash and merchandise sent to a purchasing agent for purchasing products at grossly inflated prices

2. Which of the following was used to force purchasing agents to continue buying from ACI by threatening to tell employers about the kickbacks they received?
   A. Pandora’s Box pitch
   B. Spec 20 pitch
   C. Back Door pitch
   D. Heart Attack pitch

3. Which of the following received kickbacks from ACI?
   A. ACI salespeople
   B. Purchasing agents who were responsible for the purchase of supplies
   C. Victims who uncovered the fraudulent operation
   D. Postal Inspection Service

4. What method did ACI use to conduct the majority of the business at the operation?
   A. U.S. mail
   B. Post office boxes
   C. Telephone orders
   D. United Parcel Service

5. Which of the following were more experienced salespeople who were allowed to use a variety of pitches to persuade customers to make larger purchases?
   A. Reloaders
   B. Verifiers
   C. Openers
   D. Collectors

6. Which of the following was a recurring fraudulent pitch used by a reloader as long as the customer continued to make purchases?
   A. In-Transit pitch
   B. Truck Story pitch
   C. Alaska pitch
   D. New Person Balance pitch

7. What is a red flag of a boiler room kickback scheme?
   A. Purchases previously made from out-of-state vendors are now made using local vendors
   B. The purchasing agent is buying from new vendors, all with different names and addresses but from the same area
   C. A decrease in the purchasing agent’s spending
   D. Brand name products purchased in place of generic brands
8. What is a control measure for preventing vendor kickback fraud schemes?
   A. A company policy requiring out-of-state purchases
   B. A system of lower-level approval for large purchases
   C. Requiring extensive on-site inventory
   D. Separation of duties so that a person who opens a purchase order is not the same person who can approve payment on the order
Review Answers

1. A. Incorrect. Premiums are not fraudulent pitches. Rather, these are sales tactics used in telemarketing fraud schemes.
   B. Incorrect. Premiums are not boiler room salespeople responsible for making the initial contact with a victim. Instead, this person is referred to as the opener.
   C. Incorrect. Premiums are not high-pressure sales tactics. Instead, boiler room scams involve salespeople scamming victims through high-pressure telemarketing sales tactics.
   D. Correct. Premiums are cash and merchandise sent to a purchasing agent in return for buying products at grossly inflated prices.

2. A. Correct. The Pandora’s Box pitch was used to force purchasing agents to continue buying from ACI by threatening to tell employers about the kickbacks they received.
   B. Incorrect. The Spec 20 pitch was not used to force purchasing agents to continue buying from ACI by threatening to tell employers about the kickbacks they received. Instead, this was supposed to falsely commemorate the twentieth anniversary of the company.
   C. Incorrect. The Backdoor pitch was not used to force purchasing agents to continue buying from ACI by threatening to tell employers about the kickbacks they received. Instead, if a reloader learned that the purchasing agent with whom he or she had been dealing with left the company, the reloader would contact the new hire and use this pitch to falsely represent that the former agent had ordered products from ACI.
   D. Incorrect. The Heart Attack pitch was not used to force purchasing agents to continue buying from ACI by threatening to tell employers about the kickbacks they received. Rather, the reloader would falsely represent to the purchasing agent that the previous salesperson, or opener, had suffered a heart attack and was in critical condition. The reloader would appeal to the purchasing agent’s emotions to solicit funds to assist in paying hospital bills.

3. A. Incorrect. ACI salespeople did not receive kickbacks from ACI. Instead, salespeople conducted high-pressure sales calls in an attempt to sell products that were grossly overpriced.
   B. Correct. Purchasing agents who were responsible for the purchases of supplies were offered kickbacks from ACI.
   C. Incorrect. Victims who uncovered the fraudulent operation did not receive kickbacks from ACI. Instead, if one of the company names used by ACI was compromised, either by law enforcement detection or complaints from victims, the operation would begin using a new name.
   D. Incorrect. The Postal Inspection Service did not receive kickbacks from ACI. Rather, the Postal Inspection Service investigated ACI’s fraudulent behavior.

4. A. Incorrect. ACI did not use the U.S. mail to conduct the majority of the business at the operation. Instead, invoices were sent to customers via U.S. mail.
   B. Incorrect. ACI did not use post office boxes to conduct the majority of the business at the operation. Rather, ACI operated under many company names and used various post office boxes to trick victims into believing that they were dealing with several distinct companies.
   C. Correct. ACI used telephone orders to conduct the majority of the business at the operation.
   D. Incorrect. ACI did not use the United Parcel Service for the majority of the business at the operation. Instead, once completed, UPS was one method used for sending orders to customers.
5. A. **Correct.** Reloaders were more experienced salespeople who were allowed to use a variety of pitches to persuade customers to make larger purchases.
   
   B. Incorrect. Verifiers were not more experienced salespeople who were allowed to use a variety of pitches to persuade customers to make larger purchases. Rather, verifiers contacted purchasing agents after a sale was made by an opener or reloader to verify the information on the sales order.
   
   C. Incorrect. Openers were not more experienced salespeople who were allowed to use a variety of pitches to persuade customers to make larger purchases. Rather, openers were salespeople who made the initial contact with the customer.
   
   D. Incorrect. Collectors were not more experienced salespeople who were allowed to use a variety of pitches to persuade customers to make larger purchases. Instead, collectors called victims who had not paid their invoices to find out why they had not paid.

6. A. **Correct.** The In-Transit pitch was a recurring fraudulent pitch used by a reloader as long as the customer continued to make purchases.
   
   B. Incorrect. The Truck Story pitch was not a fraudulent pitch used by a reloader as long as the customer continued to make purchases. Rather, in this pitch the purchasing agents were falsely told that one of ACI’s trucks was in his or her area and that either the truck had broken down or that the company that originally ordered the merchandise cancelled the order. The agent was offered the opportunity to purchase the merchandise at a substantial discount. No product would be shipped unless the customer agreed to make a purchase.
   
   C. Incorrect. The Alaska pitch was not a fraudulent pitch used by a reloader as long as the customer continued to make purchases. Instead, the reloader would falsely represent that he or she was relocating to Alaska to accept a promotion and that he or she could discount some products and award another gift to the purchasing agent.
   
   D. Incorrect. The New Person Balance pitch was not a fraudulent pitch used by a reloader as long as the customer continued to make purchases. Rather, if the reloader learned that the purchasing agent had left the company, he or she would ask for the prior contact’s replacement and then falsely represent that an order placed by the previous agent was being sent and required payment.

7. A. Incorrect. An obvious transition from out-of-state to local vendors is not a red flag of a boiler room kickback scheme. Instead, purchases that were previously made from local vendors that are now made from out of state is a red flag of a boiler room kickback scheme.
   
   B. **Correct.** The purchasing agent buying from new vendors, all with different names and addresses, but from the same area is a red flag of a boiler room kickback scheme.
   
   C. Incorrect. A decrease in the purchasing agent’s spending is not a red flag of a boiler room kickback scheme. Instead, an increase in spending is a red flag.
   
   D. Incorrect. Brand name products purchased in place of generic brands is not a red flag of a boiler room kickback scheme. Instead, an increase in generic products is a red flag.

8. A. Incorrect. A company policy requiring out-of-state purchases is not a control measure for preventing vendor kickback fraud schemes. Instead, a control measure should require local purchases.
   
   B. Incorrect. A system of lower-level approval for large purchases is not a control measure for preventing vendor kickback fraud schemes. Instead, require higher-level approval.
   
   C. Incorrect. Requiring extensive on-site inventory is not a control measure for preventing vendor kickback fraud schemes. Instead, a large inventory is a red flag of fraud.
   
   D. **Correct.** Separation of duties so that a person who opens a purchase order is not the same person who can approve payment on the order is a control measure for preventing vendor kickback fraud schemes.
Chapter 10
Cruise to Nowhere

Learning Objectives
- Recognize the definition of credit card factoring
- Identify the meaning of circularization
- Pinpoint a warning sign of telemarketing fraud

Introduction
There are times as a fraud investigator when you have to put yourself in the shoes of victims and look directly into the faces of fraud. That is exactly what two federal agents and I did to solve a fraud case that was targeting individual consumers and credit card companies. The fraudsters in this case were selling vacation cruises to select individuals throughout the United States. The promise was a vacation of a lifetime that turned out to be more of a nightmare. For the great majority of victims, this was a cruise to nowhere.

The Federal Trade Commission believes that Americans lose $12 billion a year in travel fraud schemes. In the 1980s, Florida was the center of fraudulent vacation cruise scams. These particular schemes sold an unsuspecting public misrepresented, and often non-existent, cruises and vacations at grossly inflated prices. As a result of aggressive investigations and prosecutions, some of these operations moved out of state. Some relocated to states such as Tennessee and New York. National Clearing Center was one such company. One of the owners of National Clearing Center had worked in a Florida boiler room and learned the business, so he decided to set up a similar operation in New York in the late 1980s.

Description of the Fraud Scheme
National Clearing Center (NCC) was set up as a traditional boiler room operation. It had a low-budget sales office in which banks of telephones were installed and where salespeople worked from scripts called pitch sheets. Remember that this was before the widespread use of computers and the Internet. Salespeople were hired through newspaper advertisements that offered telephone sales positions. Both inexperienced college students and hardened boiler room veterans were hired. NCC obtained the names of potential victims by placing advertising displays in restaurants and grocery stores offering free five-day, four-night Bahamas cruise vacations. Attached to these displays were cards that potential victims completed with personal information, and NCC had its employees pick up these response cards regularly and use them as lead sources.

The NCC salespeople would call the names on the response cards and attempt to make a sale. An important consideration was whether the potential victims had indicated on the response cards that they had a credit card. If the answer was no, those cards were discarded. As in many telemarketing schemes, the key to financial success is whether the victim has an available credit card, as credit cards allow the boiler room fraudster to quickly obtain the proceeds. Potential victims can develop buyer’s remorse and not send in promised payments or stop payments on checks that are mailed. The result is money not received by the scammers, and that is why boiler room operators prefer credit cards.

NCC had several written pitches its employees used. The premise was that the victims had won a free five-day, four-night luxury cruise to the Bahamas that would promise to be the vacation of their dreams. Victims were told numerous lies and misrepresentations. One pitch read as follows:

Congratulations, you are very lucky. The trip is valued at over $1,100 and not available to the general public. Your trip is sponsored by the hotel owners for those of you who took the time to fill out this card. The purpose of this offer is to promote tourism in the Bahamas. The cruise ship leaves from the Port of Fort Lauderdale and cruises you to and from Freeport, Grand Bahamas. On entering Freeport, you will receive 5 days and 4 nights complimentary hotel accommodations in one of the nicer hotels on the island. As stated on the entry card there is a $99 per person service fee for a total of $198 per couple that you are responsible for. The service fee covers registering, handling, and insuring the holiday passes in your name. As a bonus for registering tonight, the first 100 couples will receive a 3-day, 2-night stay in the Disney Epcot area.

Salespeople made the following false statements to prospective customers that:

- The promotion is first come, first served.
- Only a limited number of trips are available.
- As soon as the hotel rooms are filled, the promotion is over.
- It is the vacation of a lifetime.
- The trip can be taken at any time.
- They will stay in a luxury hotel in the Bahamas.
- The hotel is on the beach and has gambling facilities.
- The trip is sponsored by MasterCard and Visa.
- The only costs are a $99 per person processing fee, a $20 per person port tax, and a $90 refundable deposit.

Victims were enticed with images of a vacation on a cruise ship to the Bahamas and a stay in Freeport, Bahamas. Instead of a free trip, the victims were scammed into paying more and more money for false promises of opulent resorts. The salespeople were also provided with “objection sheets” to be used if a potential victim balked at the pitch or had a question. Objection sheets are common in boiler room operations and are used to quickly overcome any objections that the victim may have. They list the various questions a person may ask and the appropriate response to defeat the objection and thus make a sale. If the objection response does not work or the question is not covered on the sheet, then the salesperson simply hangs up and calls someone else.

Victims were told that the promotion was about to end, so they had to make up their minds right away. People who agreed to accept the trip were asked to provide their credit card information to charge the trip. If a person did not have a credit card, he or she was told by the salesperson to borrow one from a friend or relative. If the person could not get a credit card, he or she was told to send a money order or certified check.

Individuals who purchased the vacation were sent via U.S. mail an envelope containing a reservation request voucher form and other information materials with instructions on where to send the completed materials. Those who sent in the completed materials falsely thought that they were about to embark on an unforgettable cruise to a tropical paradise. How wrong they were because they forgot that time-honored warning: If it sounds too good to be true, it usually is.

There were numerous false statements made by the dishonest salespeople. The statement “Congratulations, you are very lucky. The trip is valued at over $1,100” was misleading because it implied that the customer had won something, which was not true. The statement “not available to the general public” was false because the trip was available to anyone who completed the response card. The purpose of the trip was not to promote tourism but to line the pockets of the owners and salespeople at NCC. The statement that the customer would receive complimentary hotel accommodations was false because a $99 service fee per person needed to be paid. The statement that the hotel accommodation was in one of the nicer hotels on the island was false because the facility used was Eternal Paradise Inn, which was a low-quality
accommodation commonly referred to as a flea bag hotel. In addition, there were hidden processing fees that were not mentioned to the victims.

**Detection**

Law enforcement usually learns of these fraudulent telemarketing operations from victims who realize that they have been defrauded. This is often after the operation has victimized a large number of people, closed up, and left the area. In this particular case, proactive investigative techniques resulted in early detection of this scheme. As a postal inspector in the New York metropolitan area, I maintained numerous confidential informants who were familiar with boiler room operations in the area. Many of these people were former boiler room salespeople who were arrested by me and other postal inspectors and were cooperating with us in return for reduced prison sentences.

NCC was identified for me from information provided by one of these confidential informants (CIs). This particular CI had a reputation as an excellent closer and had worked in many boiler room operations. The CI learned of NCC from other boiler room salespeople in the area. We determined that NCC was looking for salespeople for a new vacation cruise telemarketing operation that it had recently started.

**Investigation**

After I received the information about this new boiler room scam and I was able to confirm its existence and location, I began an investigation. Under my direction, the CI was able to obtain employment in the operation as a salesperson. While there are many ways to investigate a telemarketing scheme, one of the best ways is to introduce an undercover operative. This technique can quickly provide valuable evidence that, because of the nature of tape recordings, can easily be corroborated.

While working at NCC, the CI wore a body recorder to tape conversations to prove the fraud scheme. The CI was able to learn how NCC operated. He learned the names of the owners and salespeople and their phone names. He taped conversations with the owners, numerous salespeople, and administrative employees of NCC. Many incriminating statements were made among the people in the boiler room as well as false statements told to customers over the telephone.

Knowing how problematic CIs can be and how the information they provide can be attacked by defense counsel, I wanted to use a checks-and-balances approach. To accomplish that extra oversight, I had another CI obtain employment at NCC. Each CI was unaware of the existence of the other. This way I was able to ensure that the information I received could be independently corroborated via the tape recordings. I also monitored the CIs live with body transmitters while I was parked in an undercover van outside. This further ensured that the CIs were actually onsite rather than possibly staging their recordings.

One excellent source of incriminating statements was the training meetings the owners had with the salespeople prior to the start of each workday. During these meetings, attended by the entire sales staff, the owners would discuss telephone techniques to ensure a sale and various fraudulent pitches that had been successful for certain NCC salespeople. The owners would apply pressure to the sales staff and encourage them to say anything in order to make a sale. These meetings were tape recorded by the CIs and provided to me.

Some of the incriminating statements made by the owners to the salespeople at these training meetings included:

> Tell them, I have been trying to get you all week. Listen, I have some good news. Don’t give them a chance to say, Well I’ve been home, what are you talking about. Create the urgency; tell them, We’re wrapping up the promotion this evening. We need to know tonight. You have to be tough with these people on the phone. You cannot have any compassion for these people whatsoever.
You still put up with the same excuses from these people and you shouldn’t. There’s no reason to. Don’t be so freaking weak. You have to be strong. The stronger you are, the more money you’re gonna make.

Tell them MasterCard and Visa have done a real thorough background investigation on us. They actually come down to the office and inspect it. Tell them they’re as safe giving you their credit card as giving it directly to their bank. Don’t tell them about the deposit, don’t tell them about the port tax, don’t tell them anything until you get that credit card. If they say to you, are there any other charges, any hidden charges, say that the only thing going on your credit card this evening is $198. That’s it, I swear to you.

We can get away with it as long as you say it properly, say, Congratulations, you’re very lucky. Your trip is valued at over $1,100. It will give the people the impression that maybe they won. If they think they’ve won, that’s their problem. Anyone who fills out a card, they assume they’re entering a contest.

Turn skepticism to greed. Why did you let them off the phone? It’s a onetime close. There is almost no reason in the world that you should let them off the phone. People are not supposed to call you back.

The owners of the operation continued to instruct the salespeople on what to say to people they called. One of the owners told salespeople not to say that the Eternal Paradise Inn was the hotel in the Bahamas that was being used. He would tell salespeople to say that there are 13 hotels on the island and that NCC is working with 5 to 8 of them. He would tell salespeople to say to customers that MasterCard and Visa checked out the cruise, which was another false statement.

Another owner of the operation would say that the salespeople should tell customers that there were only 100 trips available in their area that night, and as soon as the rooms are filled, the promotion was over. This owner further advised that it was safe to say this because they don’t sell 100 trips in each area each night. He would also tell the salespeople to say that the hotel owners in the Bahamas pay for the trip to promote tourism, which was also not true.

Salespeople derogatorily referred to the customers as marks when talking with other salespeople. Many of them knew that the Eternal Paradise Inn was a rundown hotel, but they still continued to falsely claim that it was a luxury hotel. Salespeople told one of the CIs that they previously worked in a boiler room in Florida selling vacation promotions and had to leave because it was getting “too hot” or that the operation had been closed down by the authorities. One salesperson told a CI that she saw a news program on vacation scams and not to tell the other, newer salespeople about the story.

While victims were told that they had won the vacation cruise and that the trip was free, it was clear that this was not the case. Victims were not told the true costs. They were not told that airfare to travel to Fort Lauderdale, Florida, and the ship was not included. They were not told of other hidden costs. Victims who agreed to these additional charges were offered upgrades to supposedly more luxurious hotel accommodations. Again, the victims paid more money for a trip that was originally promoted as free. They were not told of restrictions on when one could take the trip and the true nature of the accommodations.

The majority of these travel scams never provide the promised trips to the Bahamas. It is their intention to take the victim’s money without delivering anything. After paying the fees, victims are strung along, and are told that their requested travel dates are unavailable. The delays and excuses continue until the operation finally closes down and sets up elsewhere under a new name. Only later do victims finally realize that they have been taken.

As the undercover operation at NCC progressed, one of the CIs was able to introduce a “friend” of his to the owners and recommend this person be hired. The friend was hired as a salesperson, but in reality he was an undercover postal inspector. He wore a body recorder while working at NCC and recorded additional incriminating conversations. Using the information obtained from the undercover operation, I was able to contact victims and prove that the representations made were fraudulent.
Factoring of Credit Card Charges

In my experience conducting numerous investigations of fraudulent boiler room operations, I learned that many of these operations do not have, or are unable to obtain, bank merchant credit card accounts to process credit card charges. As a result, many of these boiler rooms use another company to factor their customers’ credit card sales drafts. This type of factoring works as follows: the boiler room makes sales to customers, obtains their credit card information, and writes up the sale on blank credit card sales drafts. The boiler room then sends the sales drafts to the factoring company, which places its company credit card imprint on the sales drafts. The factoring company deposits the completed sales drafts into its bank merchant credit card account, and later withdraws the sales proceeds and returns them, less a commission, to the boiler room.

So although the customer places his or her order with the boiler room, all credit card charging and billing is completed through the factoring company. In addition, any background investigation conducted by the merchant bank is on the factoring company and not the boiler room. In the majority of cases, the merchant bank is unaware that factoring is occurring. Most merchant banks do not allow factoring due to the risk of fraud losses. In fact, credit card factoring is a potential form of money laundering. Telemarketing fraud schemes are notorious for using factoring to process fraudulent credit card transactions.

I also learned that the Miami division of the Postal Inspection Service had conducted a mail fraud investigation of a travel operation in Pompano, Florida, similar to NCC. Postal inspectors conducted a search warrant on the premises in 1988, and among the items seized were employee records. I received those records and learned that several of the owners and salespeople at NCC previously worked at the Pompano company.

Investigative Reporting

I discovered in early 1989, that the Tennessean, a newspaper based in Nashville, Tennessee, ran a 5-part series titled “The Sunshine Scam” about boiler rooms that were selling fraudulent Bahamas vacation cruises. As part of its investigation, the newspaper placed undercover reporters in a travel promotion boiler room in Sparta, Tennessee. They also sent reporters to investigate the cruise ships used and the Eternal Paradise Inn located in the Bahamas.

The reporters learned that the cruise ship departed at 8:00 a.m., which required the would-be vacationer to obtain a hotel room in Fort Lauderdale the night before. A room was also necessary when the ship returned to Fort Lauderdale five days later at 10:00 p.m. The cruise did not include cabin accommodations; a cabin was an extra charge. The hotel in the Bahamas, the Eternal Paradise Inn, was a budget-class hotel where the customer had to pay an additional $18 per night for taxes, gratuities, and electricity. Yes, electricity. The reporters also found the hotel rooms in poor condition, including fixtures and kitchenette appliances that did not work.

I also obtained a consumer complaint from an individual who was told that the Eternal Paradise Inn was a first-class, 4-star hotel, but he knew that was not true. This individual had stayed at the Eternal Paradise Inn two years earlier, and it was not a quality hotel. Additionally, the hotel was surrounded by barbed-wire fencing because it was located in a dangerous part of town.

Execution of Search Warrant

Based on all of the evidence that I had collected, I obtained and executed a search warrant for the premises of NCC in March 1989. Numerous boxes of evidence were seized pursuant to the search warrant, and although faced with a large amount of evidence, the subjects denied any wrongdoing. NCC quickly closed its operation while the government was continuing its investigation and review of the evidence seized. Within a few weeks, NCC had reopened at the same location with a new name of Airlines Travel Services (ATS).

The same fraudulent Bahamas vacation cruise was still being sold with many of the same salespeople. The pitch being used had some minor changes but was essentially the same as before. The major differ-
ence was that now ATS was sending the vacation cruise vouchers and related information using United Parcel Service and not the U.S. mail. This was done in a poor attempt to avoid prosecution through the Mail Fraud Statute.

I was able to introduce a new CI into the operation to obtain more evidence of the ongoing fraud. We also learned that ATS had actually sent a few people on a trip to the Bahamas. This discovery was a major concern because now the subjects could argue that there was no fraud even with the information I had obtained from the news story in the Tennessean. If the subjects actually provided a trip as promised, they would potentially have a defense. I needed to determine if the trip actually was provided, and if so, was it as promised. I also needed to confirm the story in the Tennessean.

### Circularization

I used an investigative tool called circularization to gather even more evidence. Circularization involves mailing questionnaires to potential victims of fraudulent operations to learn the details of their experiences and possible misrepresentations. I mailed out over 2,500 questionnaires to customers of NCC. I obtained customer information from my search warrant, and I reviewed hundreds of returned questionnaires. Among the issues that NCC customers alleged was that NCC salespeople:

- Made false statements to them including that they won a trip to the Bahamas.
- Told customers that their credit cards would not be charged until the travel vouchers were received, but in reality their credit cards were charged immediately.
- Made unauthorized credit card charges on customers’ credit cards after being told by the customers that they did not want the trip.
- Promised refunds to customers that were never made.
- Did not tell customers of the hidden costs of taking the trip.
- Told customers that postal inspectors had refused to return the originally seized records and thus refunds could not be made. This was another false statement as NCC had access to everything seized in the search warrant.

I spoke with many of these victims. They were under the impression that they had won their trip. They agreed to initial processing fees to obtain their vacations. These customers were told they had only to pay a $99 per person processing charge, a $22 per person Bahamas port tax, and a $100 refundable deposit. Subsequently, these customers were faced with charges for upgrading hotels, taxes, tips, meals, and additional processing fees.

I then spoke with individuals who went on the Bahamas vacation cruise. There were only four of them. They confirmed that they had to pay hidden costs in order to go on the trip, and they were not told of these additional charges at the time of the purchase. While customers were initially told in the pitch by salespeople that this promotion did not involve timesharing, customers who went on the trip were forced to sit through timeshare sales presentations. One victim advised that this was “the most miserable vacation we ever had in our lives.” Victims were told that the Eternal Paradise Inn was a quality hotel, but they later learned it was a low-quality hotel. In some cases, victims were told that the Eternal Paradise Inn was totally booked and they were forced to pay upgrade fees to obtain hotel accommodations at other island hotels.

I went ahead and obtained a new search warrant for the premises of ATS in May 1989. As before, I collected numerous boxes of evidence.

### Undercover Trip

I decided to take an undercover trip to the Bahamas to determine the truth about the vacation cruise since so few people actually took the trip. The defendants could claim that this was not a fraud since they did provide a trip even if only a few trips were taken. If we were successful on our planned undercover trip, we would be able to determine firsthand the particulars of the vacation cruise. We would put ourselves in the victims’ shoes. It would also make for the best evidence in having federal agent eyewitness testimony.
I was able to obtain travel vouchers from three people who dealt with ATS and were planning to take the trip. I, along with two Secret Service special agents, assumed the identities of these three people and took the vacation cruise to the Bahamas. When we tried to schedule the travel in our undercover capacities, we were met with obstacle after obstacle. Every date we asked for was booked. We finally ended up saying that we would take whatever days were available. After several delays and excuses for postponing the trip, we were given dates by ATS for the vacation cruise. From the stalling process that occurred in scheduling the trip, I could see how victims eventually gave up without taking their vacations.

At this point, the “free” Bahamas cruise vacation had cost a substantial amount of money. I learned that the trips were only provided in groups of four. So, if we went with only two or three people, we would still be charged for four people. We were charged $396 ($99 per person) for the processing fee, and then had to pay $360 ($90 per person) for a refundable deposit to ensure we actually took the trip. We were told that this money would be refunded at the conclusion of our vacation. We then had to pay $80 ($20 per person) for a Bahamas port tax to enter the country.

While we were told that the hotel provided in the travel package was first class, we were given the opportunity to upgrade to a 5-star hotel in the Bahamas for a slight additional fee; this upgrade cost us an additional $35 each. We learned that the airfare to Florida was not included and that was a cost of approximately $300 each. We learned that prior to our departure on the cruise ship, we were given reservations in a hotel in Fort Lauderdale, that would cost us $49 per person per night for two nights.

While it is not uncommon for investigators to work undercover, what was unusual about this particular operation was the venue. We would be working undercover in Florida and then in the Bahamas, a foreign country. We would photograph and videotape as much as possible to provide recorded proof of what we saw and experienced. In addition, a written log of all daily activities and copious notes would be maintained. Discreet interviews would be conducted of other victims and possible suspects to develop additional evidence.

We had a chance to be put into the shoes of a victim and experience the frustration, humiliation, and anger of being cheated. Personally experiencing this victimization can be advantageous for a fraud investigator to help them better understand the victim’s predicament. As undercover agents, we quickly learned that we were on a nightmare vacation. While a trip was actually provided, it was nothing like the representations originally made. We encountered a cruise that was anything but a cruise with many hidden costs, a stay at a flea-bag hotel, and a chance to meet many other people who had also been defrauded.

We knew we were in for an adventure when we landed in Fort Lauderdale and got into a taxi for the ride to our hotel. We struck up a conversation with the cab driver when he asked what we were doing in Florida. We took our role as victims seriously and played the part. I said that we had just won a five-day, four-night cruise to the Bahamas. The driver’s response was “You’re here on that scam,” and he proceeded to tell us of all the complaints he heard about and the hidden charges.

We had to pay for the hotel in Fort Lauderdale for the day before the cruise. All the victims were told to stay at this hotel. The next morning we were herded onto an old, rundown bus for the trip to the port, and we had to pay for the travel from the hotel to the ship. When we arrived at Port Everglades, we found an actual ship, but then reality set in. The cruise was actually a four-hour ferry ride from Port Everglades, Florida, to Freeport, Bahamas. Nothing was provided during the cruise. We sat on folding chairs on the deck and had to pay for our meals and any additional services. If we wanted a room on the ship for the four-hour trip, we would have to pay extra.

When we arrived in Freeport, Bahamas, we had to pay for transportation from the ship to our hotel. While we had been told that the Eternal Paradise Inn was a quality hotel, it was recommended that because we seemed like upscale folks, we should stay at an even nicer hotel. The Freeport Heavenly Hotel was recommended for the upgrade. The “upgraded” hotel turned out to be a rundown hotel unlike anything described by the boiler room salespeople. Most noticeable was the barbed-wire fence surrounding the hotel. We were told that it was for our safety because we were in a bad section of town and the barbed wire kept the undesirables out. The air-conditioning did not work, and I was warned that the electricity was prone to power outages. My room had two double beds, a linoleum floor, a 12-inch television, and not much more. The beds were broken and sagging, and the bed sheets were torn and dirty. The small
bathroom had a broken shower door. I also found that I was not alone in the room for I had visitors, the six-legged kind; there were cockroaches in the room I was assigned.

The other hotel guests started complaining. While there was a pool, it was not operational. One victim asked where the casino was, that she had been told there was a busy casino at the hotel. There was no casino. People started referring to the Freeport Heavenly Hotel as Satan’s Revenge and Hotel Hell. Some people said we were all suckers and idiots. The hotel manager tried to calm us down by saying the hotel had the best location on the island. He unfortunately asked if everyone was happy and the response was a resounding no. When I noticed there were no phones in the rooms or a pay phone in the lobby, the manager said they had been waiting two years for a phone. (This took place well before the use of cell phones and the Internet.)

The two Secret Service agents said there was no way they were staying in this dump. While I appealed to their sense of duty to stay and be able to testify firsthand about the miserable conditions, my appeal fell on deaf ears. They quickly retreated to the local Holiday Inn, along with a few other guests. True blue, I stayed at the Freeport Heavenly Hotel so I could later testify about my experience. When I visited the agents at the Holiday Inn, I could see the night and day differences between the hotels.

The unfortunate victims who did not have the money to move to another hotel commiserated with me about their victimization and ruined vacation. Posing as a victim, I was able to glean valuable information about their experiences and misrepresentations. Sadly, there were newlyweds on their honeymoon, and the bride was beside herself. She complained mightily to the person at the front desk, but he was just a local worker running the reception desk and had no idea what was going on and could offer no assistance. I learned that the only people who were staying at the hotel were victims of this travel scam.

All food, beverages, entertainment, transportation, and incidental charges were not included and came out of the pockets of the victims. On the ferry ride back to Port Everglades (I wouldn’t call it a cruise), the victims, now completely dejected from their experience, sat together on the ship’s deck and complained about how they had been deceived. It was the culmination of five days and four nights of frustration. Many said they were going to file complaints about how they were lied to, and we secretly documented all this information for our case.

When we arrived back at the hotel in Fort Lauderdale, we were met with another deception. We were told that we had to attend a time-sharing presentation. When many of us protested, we were told that it was a requirement. If we didn’t attend, our last night’s room expense would be charged to the credit card we gave when we registered. We had been told that the credit card imprint was only for incidentals and the room was free. Now we were told that the free room came with a cost. So, we attended the time-share presentation. I wanted to see how this was tied to the overall fraud.

The pitch used in the time-share presentation was quite unique. The presenter said that we had just experienced the horrors of the Eternal Paradise Inn and Freeport Heavenly Hotel. He opined that compared to that experience, this beautiful hotel in Fort Lauderdale was paradise, and why wouldn’t we want to buy a time-share here? There was a high-pressure sales approach, and the already beaten-down victims were beaten down even more. When I explained all that we had been through to now experience this, the salesperson said, “You’re from New York, you should know that you get nothing for free.”

Clearly, we had been lied to and deceived. This was not the vacation of a lifetime. It was the cruise to nowhere. The evidence needed had been obtained to conclusively prove the fraud.

**Prosecution**

Once back in New York, the new evidence was provided to the U.S. Attorney’s Office for prosecution. Arrest warrants were obtained for the three owners, several salespeople, and an administrative employee of NCC and ATS. They were arrested and charged with conspiracy, mail fraud, wire fraud, and credit card fraud. They learned that federal agents had taken the trip and were able to prove that the vacation cruise was a fraud. Subsequently, the defendants agreed to plead guilty, and received various sentences of home detention, probation, fines, and restitution.
Special Circumstances

The government was able to uncover the scheme relatively quickly due to the early introduction of the CIs into the boiler room. While this is not always possible, this approach was responsible for ending the fraud and limiting the losses to the public and the credit card issuers. Federal sentencing guidelines in fraud cases are dependent upon several factors, including the role of the defendant in the scheme, how long the scheme was in operation, the amount of money obtained by the defendant and the public loss, the defendant’s acceptance of responsibility, and their cooperation with the government. In this case, all of these factors played a part in the final sentences for the defendants.

In this particular case, the defendants thought that they could remove the possibility of prosecution by actually providing a trip. Their plan was to provide a small percentage of the victims a trip, albeit not the one so falsely described so that they could claim they did indeed provide a vacation. While boiler room operators sometime use this strategy to evade criminal charges, it does not usually work. The statements made by the defendants and relied on by the victims are crucial to the state of mind of those deceived by the fraud.\(^2\)

Fraud Prevention

A telemarketing fraud scheme often begins when you receive a postcard or letter in the mail, an e-mail, a voice mail, or see a pop-up ad on an Internet site describing an appealing offer. To take advantage of the offer, you’re told to call a number. When you call, the telemarketer has a convincing pitch. Consumers can protect themselves from becoming fraud victims by remembering the following tips, which will help them to decide whether or not to deal with the promoter. Fraud investigators also need to know the red flags of telemarketing fraud to be evangelists of fraud prevention. The red flags include:

- The offer sounds too good to be true.
- You are told you won a prize, but you must pay for something.
- The telemarketer insists on an immediate decision.
- Your credit card number is requested for verification.
- You are urged to provide money quickly.
- You are given no detailed written information.
- You are asked to trust the telemarketer.

Other red flags of telemarketing fraud sales pitches include:

- You’ve been specially selected to receive this offer.
- You’ll get a wonderful free bonus if you buy our product.
- You’ve won a valuable free gift.
- This investment is low-risk and provides a higher return than you can get anywhere else.
- You have to make up your mind right away.
- This offer expires today.
- It’s free, but you can just put the shipping and handling charges on your credit card.

Investigative Best Practices

I used a number of investigative best practices in this fraud case. Informants were important in disclosing the scheme to me, and then in my deploying them as undercover operatives inside the boiler room operation. Search warrants helped me seize valuable documentary evidence to further understand the scam and build a criminal case for prosecution. The ensuing prosecution resulted in guilty pleas by culpable salespeople who provided additional and corroborating information. I love imagination, and it can be very effective in advancing a fraud examination. Using imagination as an investigative tool (as detailed in Chapter 3 and elsewhere in this book), I took the undercover trip to the Bahamas to prove once and for all

\(^2\) The names of the hotels mentioned in this case study have been changed.
that this was not “an unforgettable cruise to a tropical paradise” as promised. In reality, it was a cruise to nowhere and the undercover operation showed that. Being in the shoes of a victim not only proved the fraud but also brought me eye-to-eye with the faces of fraud.
Review Questions

1. Which of the following is used in boiler room schemes when fraudsters are faced with resistance during telemarketing calls?
   A. Victims referred to the National Clearing Center
   B. Incentive that lowers cost to $99
   C. Objection sheets
   D. Checks-and-balances approach

2. What are telemarketing salespeople told to do during calls?
   A. If questioned about additional fees, immediately provide tax information
   B. Don’t ever answer questions regarding amounts being charged to credit cards
   C. Turn skepticism to greed
   D. Give them the option to call back

3. Which of the following is used to process all fraudulent credit card charging and billing?
   A. NCC
   B. Certified checks
   C. Bank merchant credit card accounts
   D. Factoring companies

4. What investigative tool is used to gather details from potential victims?
   A. Circularization
   B. Credit card factoring
   C. Investigative reporting
   D. Undercover investigation

5. Which of the following is a red flag of telemarketing fraud?
   A. Offers that initially sound too good to be true but do provide value
   B. Failure to receive written information
   C. You are not asked to trust the telemarketer
   D. Your credit card number is not immediately requested

6. What is a common telemarketing fraud sales pitch?
   A. We will send a free gift before you commit to buying
   B. The investment is high-risk but provides a higher return
   C. It’s free, but you can put just the shipping and handling charges on your credit card
   D. This offer expires in 48 hours
Review Answers

1. A. Incorrect. Victims are not referred to the National Clearing Center in boiler room schemes when fraudsters are faced with resistance during telemarketing calls. Instead, the NCC was set up as a traditional boiler room operation.
   B. Incorrect. An incentive that lowers the cost to $99 is not used in boiler room schemes when fraudsters are faced with resistance during telemarketing calls. Instead, this is a sample statement used by salespeople in boiler room schemes.
   C. Correct. Objection sheets are used in boiler room schemes when fraudsters are faced with resistance during telemarketing calls.
   D. Incorrect. A checks-and-balances approach is not used in boiler room schemes when fraudsters are faced with resistance during telemarketing calls. Rather, this is an approach used by investigators to confirm information gathered by a CI. For example, an investigator may hire two CIs without telling them about each other.

2. A. Incorrect. Telemarketing fraudsters are not told to only provide tax information if questioned about additional fees. Instead, they are told to never give any information regarding deposits, taxes or any other additional fees until they have the credit card number.
   B. Incorrect. Telemarketing fraudsters are not told to refrain from answering questions regarding amounts being charged to credit cards. Instead, they are told to provide limited information regarding the base price of the product.
   C. Correct. Telemarketing fraudsters are instructed to turn skepticism to greed to make the sale.
   D. Incorrect. Telemarketing fraudsters are not told to give them the option to call back. Conversely, they are told to make the sale during the initial call, without fail.

3. A. Incorrect. The NCC is not used to process all fraudulent credit card charging and billing. Instead, the NCC is a company that hires fraudulent salespeople for the purpose of committing fraud.
   B. Incorrect. Certified checks are not used to process all fraudulent credit card charging and billing. Instead, victims who did not have a credit card were instructed to make payment using a certified check.
   C. Incorrect. Bank merchant credit card accounts are not used to process all fraudulent credit card charging and billing. Instead, many fraudulent organizations are unable to obtain a bank merchant credit card account, forcing them find an alternative way to complete the order.
   D. Correct. Factoring companies are used to process all fraudulent credit card charging and billing. Most merchants’ banks do not allow factoring due to the risk of fraud losses.

4. A. Correct. Circularization is an investigative tool used to gather details from potential victims.
   B. Incorrect. Credit card factoring is not an investigative tool used to gather details from potential victims. Instead, credit card factoring is used to process fraudulent orders.
   C. Incorrect. Investigative reporting is not an investigative tool used to gather details from potential victims. Instead, investigative reporters may go undercover to determine the validity of the product being sold.
   D. Incorrect. An undercover investigation is not an investigative tool used to gather details from potential victims. Instead, investigators may go undercover to experience the scam in the same context as victims.
5.  A. Incorrect. Offers that initially sound too good to be true but do provide value are not a red flag of telemarketing fraud. Telemarketing fraud rarely involves offers which have any actual value.
   B. Correct. Failure to receive written information is a red flag of telemarketing fraud.
   C. Incorrect. This is not a red flag of telemarketing fraud. Instead, being asked to trust the telemarketer is a red flag.
   D. Incorrect. This is not a red flag of telemarketing fraud. Rather, requesting your credit card number immediately for verification is a red flag of telemarketing fraud.

6.  A. Incorrect. Offering to send a free gift before you commit to buying is not a common telemarketing fraud sales pitch. Instead, the victim is told he or she will receive a gift after placing an order.
   B. Incorrect. Being told an investment is high-risk but provides a higher return is not a common telemarketing fraud sales pitch. Instead, victims are told the investment is low-risk with higher returns.
   C. Correct. Being told something is free, but you need to put the shipping and handling charges on your credit card is a common telemarketing fraud sales pitch.
   D. Incorrect. Being told an offer expires in 48 hours is not a common telemarketing fraud sales pitch. Instead, victims are told the offer expires today.
Chapter 11
Who’s Who of Fraud: A Story of Vanity and Deception

Learning Objectives

- Recognize a technique used by fraud telemarketers when victims question the validity of the offer

Introduction

French philosopher and novelist Jean-Jacques Rousseau in Émile, Or Treatise on Education said, “Provided a man is not mad, he can be cured of every folly but vanity.” The fraudsters in this case study must have been avid readers of Rousseau for vanity was their weapon, and deception was their intent. In the process they obtained millions of dollars from tens of thousands of victims.

Everyone wants to be liked, well thought of, and respected. We enjoy recognition for a job well done, a significant achievement, or a lifetime of accomplishments. When we receive recognition and accolades, we feel special. It pumps us up and makes us proud of ourselves. No one wants to be known as a loser. That is exactly what a group of ingenious fraudsters focused on when committing a very unique scam. Rather than appeal strictly to greed, these criminals appealed to people’s ego and vanity as a back-door approach to empty their wallets.

Do you remember the scene from The Wizard of Oz where Dorothy, the Scarecrow, the Cowardly Lion, and the Tin Man confront the all mighty Wizard? They all wanted something from him. The Scarecrow wanted a brain. The Lion wanted courage. The Tin Man wanted a heart. Remember what the Wizard gave them? He gave the Scarecrow a diploma, the Lion a medal, and the Tin Man a testimonial, a watch. In a way, that is what the victims in this case study wanted. They wanted recognition, appreciation, and a sense of self-esteem. Instead, they received a cheap plaque, a useless book, and ultimately a blow to their egos.

The Making of a Fraudster

Julius Bernstein claimed to be a true American success story. Rising from the poverty and crime of Bronx, New York, he graduated from the prestigious Wharton School of Business at the University of Pennsylvania in the early 1960s. Along the way he changed his name to Jim Burke because he felt his given name was too ethnic and he wanted something with more zip. He became a self-made millionaire. He was the founder and chairman of numerous companies including a toy manufacturer, a pet food manufacturer, a gold and silver exchange, and a telemarketing consulting company.

Burke claimed to be the best-selling author of numerous books on a variety of topics including how to get rich quick, how to live a long and full life, and how to improve one’s sex life. He claimed to advise many of the Fortune 500 companies. Burke was written up in the Wall Street Journal, New York Times, Forbes, and other magazines and newspapers. He appeared to be larger than life and his charismatic personality and self-assuredness reinforced that image.

But Jim Burke was not the person he claimed to be. He quickly learned how easy it was to become a master illusionist. In fact, he is quoted as saying “People tend to believe illusions” and “Just remember—the role you will be playing requires constant practice.” While he owned many companies, most were not successful. He would make up names of nonexistent senior partners to give the appearance of legitimacy and experience. He wouldn’t pay his bills and went bankrupt when the bills piled up. When he couldn’t find a publisher for his books, he published them himself. Many of the people he claimed to know and do business with had never heard of him. While he was the subject of many articles in newspapers and magazines, they were usually derogatory. By the 1980s, Burke was concentrating on providing telemarketing consulting, advertising, and training services.
Chapter 11 – Who’s Who of Fraud: A Story of Vanity and Deception

**Fraud Scheme**

In early 1988, Jim Burke began marketing a biographical directory, *Who’s Who in American Executives*, in Great Neck, New York. The company operated in a boiler room atmosphere. Its sales operation used high-pressure telephone sales pitches that misrepresented the company and the products sold in order to induce customers to buy books, plaques, press releases, and related merchandise.

The products sold by Burke’s company were misrepresented to be items that commemorated the customer’s membership in an exclusive organization, *Who’s Who in American Executives*, *Who’s Who in U.S. Executives*, or *Franklin’s Who’s Who*. The company falsely represented to customers that these were long-standing, well-known, and recognized reference sources that published highly selective biographical reference directories. Many of the potential customers contacted were small and mid-size business owners, managers, and executives who believed they were solicited by *Marquis’ Who’s Who*, which possesses the registered trademark to Who’s Who in America. *Marquis’ Who’s Who* is a legitimate and internationally known directory.

From the time Burke began marketing the directories until July 1991, several million personalized solicitation letters were mailed to customers. The addressees’ names were, for the most part, obtained from list management companies and list brokers. Lists identifying executives were often used, as were general business listings, and magazine subscriber listings which included the names of middle management and lower level employees.

Several variations of these solicitation letters were used. One example of an initial solicitation letter stated that the customer had been “confidentially nominated for inclusion in Who’s Who in U.S. Executives by one of our members.” Another fraudulent variation stated “The President of a company well known to you with substantial business dealings in [the addressee’s state] has confidentially placed your name into nomination.” Still another fraudulent variation stated “Please respond as quickly as possible, as we have a quota from all states including [the addressee’s state].” These statements were false because there were no third-party nominations or quotas for states.

A blank biographical questionnaire was included with the solicitation letter. Upon return of the completed application to the company, the forms were given to the telemarketing sales department where telephone salespeople then contacted the applicants. The salespeople, using scripts and high-pressure sales techniques, telephoned the customer, often introducing themselves as vice president, associate director, or chairman of the nomination committee. In substance, the salespeople told the customer that the purpose of the call was to determine the customer’s eligibility for inclusion in one of the company’s directories. They then asked questions allegedly to determine if the customer qualified for inclusion in Who’s Who. These questions focused on membership in organizations or accomplishments and preceded a sales pitch.

At the conclusion of the questioning, the salesperson told the customer either he qualified to be included or would be recommended for inclusion in a Who’s Who directory. During these initial telephone conversations, the salespeople made numerous misrepresentations including that the customers were:

- Being considered for inclusion in these reference manuals as a result of a selection process based upon strict standards of acceptance.
- Reviewed by a selection committee which included the names of several well-known personalities or persons holding prominent titles. These people had no involvement in the company and were not part of any selection process but salespeople told customers these people had been instrumental in selecting them.
- Nominated by a third party for inclusion and were not told that their names really came from mailing lists.
- Told that there were a limited number of persons who would be accepted into the Who’s Who directories.
- Told that no more than 10,000 people would be accepted, whereas over three million individuals received solicitations to be included in the directory.
Told that they must engage in a qualifying telephone interview to prove they were a leading person in their profession. The qualifying interview was a ruse to gain the customer’s confidence leading to a sale.

Told that the directories were regularly purchased by and generally available in libraries.

Falsely told about the involvement of famous people with the company. For example, Lee A. Iacocca, former chairman of Chrysler Corporation, was described as a member of Who’s Who and was prominently featured in the company’s advertising and promotional campaign. Other people mentioned in the company’s pitch included Donald J. Trump, president of the Trump Organization; Oprah Winfrey, American media proprietor, talk-show host, actress, and philanthropist; and the late Helen Gurley Brown, then editor-in-chief of Cosmopolitan magazine.

Falsely told about the directories’ closing, printing, and shipping dates.

Falsely told about the number of different directories in print.

Falsely told that the company was responsible for managing the President’s Advisory Council on Business and Industry.

At the conclusion of the initial conversation, the salesperson used high pressure sales tactics to induce the customer to purchase the directory and other products at a prepublication price. The customer would also be told that the directory would be closing soon, thus the need for a quick purchase.

The average sale was between $100 and $500 and was usually paid by credit card or check. The most frequently purchased items were directories and plaques. The plaques cost approximately $5 to make but were sold for around $80. The directories sold for approximately $100. If a customer wanted a photograph included, it cost an additional $75. Initially, salespeople received a higher commission per sale for credit card sales because credit cards meant quicker access to the victim’s money than a check. To charge customers’ credit card accounts, Burke needed to have the use of a merchant account with a financial institution, through which the company could deposit credit card charges. Jim Burke had his wife, Monica Burke, open merchant accounts at various New York financial institutions.

While Jim Burke was the real owner and principal operator of the company, he used his wife as the nominal president of the company. This was because Burke and his wife had conspired to evade the payment of their personal income tax liability for the years 1975 through 1978 by shifting income and assets to his wife. The case against the Burkes originated from an investigation by the Internal Revenue Service (IRS). The investigation revealed that Jim Burke failed to report income owed of $625,000 including tax and penalties. The Burkes made false statements and submitted false documents to the IRS in order to impede the payment of Jim Burke’s personal tax liabilities. They concealed the interest of Jim Burke in various assets and business interests and intentionally understated his income and assets.

The Burkes wanted to create the illusion that Jim and Monica Burke were separate financial entities and did not have the income or assets to pay the IRS the liability imposed. In fact, in 1985, Burke falsely claimed he was separated from his wife, had no assets, and was making very little money and could only afford to pay the IRS $150 a month. This was the reason that Burke made his wife the president of the company and had her open the credit card merchant accounts in her name.

By early 1990, Burke’s boiler room operation had grown to over a hundred people including managers, salespeople, customer service, collection, and administrative employees at two locations. The Great Neck, New York, location was still the main office but a new sales office had opened in Forest Hills, New York. The company was bringing in approximately $900,000 a month in sales. Burke had several sales managers at his operation, one of whom was Aaron Edwards. They ran the sales force, trained the new salespeople, and received an override on the commissions earned by the salespeople under their supervision. The managers also provided the sales scripts to the salespeople, which were authored by Burke. In addition, there was a manager of customer service and collections.

Salespeople continued to make misrepresentations to customers. The phony names of Thornton Rockefeller and Harlan Carnegie were signed on the solicitation letters and plaques. Customers were told that these were real people who were related to their famous namesakes and who were actually involved in the company. This was not true, but the use of these nonexistent people gave the appearance of wealth,
power, and credibility. By March 1990, only two volumes of *Who’s Who in U.S. Executives* had been printed and there were only a few thousand of each volume. The company continued to solicit for other directories including *Who’s Who in the Computer Industry* and *Who’s Who in Practicing Attorneys*.

Burke and his salespeople would comment internally to one another about their selling techniques and how to deal with customers. “Play up the customer’s vanity,” Burke said. “They have plenty of money, $200 or $300 is nothing to them.” One salesperson said, “The quicker you get the money, the better for all of us. And that’s really the bottom line.” Another said, “We say we’re associate directors. It sounds good. But this is how you make sales. The nomination pitch is BS. It’s a mystery book.” Burke would also instruct his salespeople on how to close sales by saying, “If you sound like you’re strong, people don’t want to take you on and challenge you. If they ask, ‘What’s the scam?’ Answer, ‘I beg your pardon! Do you think a hundred thousand of the most important people in America are involved in a scam?’ You gotta push these people back.”

The problems started to mount. The company failed to ship directories to customers. When directories were shipped, they often contained mistakes or omitted members. Customers’ credit cards were being double charged at times. Refunds were not made as promised. Burke told the employees that it was more important to bring money into the company than to make refunds. In an attempt to make more money, Burke started a “Who’s Who Gift and Personal Services Catalog,” which was sent to Who’s Who members. Customers who ordered merchandise from the catalog often found that they received neither the ordered goods nor a refund.

By April 1990, the company lost all three of its credit card merchant accounts due to excessive charge backs from unhappy customers. The company now had to resort to invoice billing and receiving payments by check or money order. When customers called to cancel orders, they were falsely told that they could not cancel their orders because the plaque and book manufacturing processes were already under way and the merchandise was customized. When customers complained about not receiving promised credit card refunds, they would be sent a letter falsely telling them that the reason they didn’t receive their credit was because of an internal computer problem at American Express. The letter read:

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Dear Who’s Who Member:
Because of a technical, internal computer problem with American Express (which had nothing to do with your outstanding credit reputation) American Express was unable to make a payment to us on those items charged to your credit card.

To expedite matters, we have therefore credited your charge account and are enclosing an invoice to you which you should pay to us directly.

You may deduct your American Express credit memo from your next payment to them. Please be good enough to pay us directly. You will note that the invoice has an additional 3% discount for payment within 10 days.

In addition, you will receive a Who’s Who lapel pin valued at $39 in consideration of your prompt payment.

Very truly yours,
Jane Hanson
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**Investigation**

The investigation started in December 1989, after the Postal Inspection Service began receiving numerous complaints from Who’s Who customers, the credit card industry, the Better Business Bureau, and other law enforcement agencies. It was clear that this was going to be a tough and complex case.

I knew that this investigation would need significant law enforcement resources due to the large number of potential victims and defendants, as well as the multitude of documents that would need to be reviewed whether by subpoena or search warrant. Federal agents from the U.S. Secret Service and the IRS Criminal Investigation Division, and I started a task force investigation of Jim Burke and his Who’s Who.
operation. Numerous victims were interviewed, as were many former sales and administrative employees of Burke.

A confidential informant obtained employment at the direction of the task force at the Great Neck location. The informant worked as a salesperson from April to June 1990, and throughout this period wore a concealed tape recorder to gather evidence. The informant tape recorded sales meetings conducted by Burke and the sales managers, as well as conversations with other salespeople. By June 1990, Who’s Who had brought in approximately $9 million in sales.

The multitude of tape recorded conversations was a goldmine of evidence. Contemporaneous and spontaneous undercover conversations with employees of the boiler room operation provided insight into the fraud and became the best evidence of the crimes. Among the very telling and deceptive comments made by the fraudsters were the following:

“Tell the customers we start to make the plaque within 24 hours. Who’s Who will be stuck with a plaque with the customer’s name on it, and we can’t continue your membership in Who’s Who if your first official act is to take advantage of us.”

“It’s a whore’s business. Go for the jugular. A book and a schmuck. It’s a telemarketing scam.”

“That’s not exactly what we tell them. In other words, what it says, your name has come to us, or you’ve been nominated. Okay, but that’s where you sometimes get into trouble because not everyone is nominated. If they ask, who nominated me, what we say is ‘If you were nominated, sir, your name was given to us in confidence because not everyone is chosen.’ And if they push and say I have to know who nominated me, we say ‘Sir, now once we get the names and the letters mailed to us, members or potential members, we don’t keep that on file because it’s too many people involved.”

“When I get my check I always cash it right away because I never know when I might come to work and find locks on the door.”

On June 11, 1990, postal inspectors and special agents with the Secret Service executed search warrants at the Great Neck and Forest Hills offices of Who’s Who. Among the evidence seized from the search were financial records, pitch sheets, commission sheets, personnel records, computer software, sales training manuals, customer files, customer complaint letters relating to merchandise misrepresentation, failure to refund and failure to render ordered merchandise, credit card charge backs, and other business books and records.

While many employees left the company after the search warrants, Burke continued his fraudulent operation with only minor changes. He hired new employees to replace the ones who left. He promoted two people to be managers of customer service and collections. The solicitation letters and pitch sheets were revised but still contained misrepresentations. By the fall of 1990, Burke changed the name of the company to Burke’s Who’s Who. Refunds were made only to customers who threatened to complain to law enforcement or consumer protection agencies. The task force continued its investigation of Burke’s operation.

In February 1991, the first employee of Burke’s operation pleaded guilty. Aaron Edwards had worked for Burke since January 1990, at the Great Neck location. He started as a salesperson and quickly became a sales manager. Edwards was well known to me and to other postal inspectors. In April 1990, I arrested him and charged him along with 21 others in another boiler room operation that fraudulently sold chemical and computer products, and bribed purchasing agents. In April 1990, Edwards was indicted on charges of conspiracy and mail fraud for his criminal involvement in this boiler room.

Burke was well aware of Edwards’s criminal past when he hired him. Edwards continued to work for Burke even after the search warrants were executed in December 1989. Edwards eventually decided that fighting the government was fruitless since his career as a fraudster had finally caught up with him. Edwards’s guilty plea in February 1991 included charges of mail fraud and wire fraud for his crimes at both boiler rooms.
As the business continued to deteriorate, Burke closed the Great Neck location in April 1991, and consolidated the operation at the Forest Hills location. During this time, Jim and Monica Burke were building a 10,000 square foot luxury estate on 6.2 acres in tony Mill Neck, New York. Again, to hide his assets from the IRS, Burke had the purchase of the property and the ownership of the house placed in his wife’s name. In fact, the purchase of the property and the building of the home were financed by funds siphoned from Who’s Who.

By the spring of 1991, Burke’s operation had sold customers tens of thousands of plaques and directories for Who’s Who in U.S. Executives, Who’s Who in the Computer Industry, Who’s Who of America’s Practicing Attorneys, Who’s Who in Real Estate, Who’s Who in Health and Medical Services, Who’s Who in American Accounting, Franklin’s Directory of America’s Leading Engineers, Burke’s Who’s Who in Federal, State, and Local Government Personnel, Burke’s Who’s Who in U.S. Law Enforcement Leaders, and several others. The Who’s Who for law enforcement was the most shocking as it targeted law enforcement officers throughout the country.

The victimization of police and federal agents, while surprising, is not beyond belief. While we would hope that law enforcement professionals would have a higher level of suspicion to fraudulent pitches and promotions, human emotions and naïveté know no boundaries. The scammers would tell law enforcement officers that they were chosen because they were the best and the brightest in their profession. They were told they were being honored with exclusive inclusion in the law enforcement directory and that a plaque further honoring them was being prepared. Of course, this was all for a price that was a pretty penny. Law enforcement officers fell for this scheme just as much as other victims did.

While most of the ordered plaques were shipped to customers, only a few of the directory titles were ever printed and shipped. As complaints continued to increase, Burke instructed his employees to send lulling letters to the customers. Among the various excuses told to the victims was that there was a major computer malfunction within the company that caused the loss of customers’ names and orders. Complainants who contacted the Postal Inspection Service advised the following:

- Merchandise that was ordered and paid for was not received.
- Promised refunds were not received.
- Victims received slips from Who’s Who showing credit to their credit cards accounts, but they were never credited because the merchant accounts had been closed many months before.
- Victims were falsely told that their refund checks were in the mail.
- Victims received invoices for unordered merchandise.
- Victims who never received ordered merchandise were told that the company had no record of their orders.
- Victims received letters from the company offering only a 10 percent refund.

On July 24, 1991, Burke closed down the Great Neck location and moved the entire operation into his apartment in Floral Park, New York. He fired many of the employees but kept the top salespeople to work the telephones out of his residence and continue the business. He now called the business Burke’s Who’s Who. On July 26, 1991, Who’s Who in American Executives filed for bankruptcy.

I obtained two search warrants to seize further evidence in this investigation. On July 31, 1991, postal inspectors and special agents with the Secret Service and the IRS and I executed search warrants at the Forest Hills and Floral Park locations. Among the evidence seized were financial records, customer complaints, computer equipment, pitch sheets, and sales records. After these search warrants, Burke closed down the business for good. It had brought in over $14 million since the operation began three years earlier.

On August 8, 1991, postal inspectors and special agents with the Secret Service and the IRS and I executed a search warrant at Burke’s Mill Neck estate that was under construction. It was learned that Burke had moved boxes of financial records, customer complaints, and Who’s Who books to the site. This evidence was seized.
On September 17, 1991, the team and I executed a search warrant at a storage facility in Long Island City, New York, where Burke had moved file cabinets containing sales orders, charge backs, and other business books and records. This evidence was also seized.

The task force continued its investigation of Burke and his operation. More than 10,000 victims were contacted by mail and given a questionnaire to detail their experience. I again used the circularization process as an investigative tool, and I received thousands of detailed responses from victims. Dozens of former employees were interviewed, as were accountants and contractors involved in the building of the Mill Neck estate.

**Prosecution**

On May 20, 1992, Jim Burke and 18 managers and salespeople were arrested and charged with mail fraud and wire fraud for their involvement in the operation. Monica Burke was arrested and charged with filing a false mortgage application with Citibank for the construction of the Mill Neck estate.

Between June and December 1992, 15 of the managers and salespeople pleaded guilty to charges of mail fraud and wire fraud in the Eastern District of New York. On January 4, 1993, two managers and a salesperson were indicted on 17 counts of conspiracy, mail fraud, and wire fraud for their criminal involvement in the Who’s Who operation.

On March 3, 1993, Jim and Monica Burke pleaded guilty in U.S. District Court, Eastern District of New York. Jim Burke pleaded to six counts of conspiracy to commit mail and wire fraud, mail fraud, tax evasion, and making false statements to the government. Monica Burke pleaded to three counts of mail fraud, tax evasion, and filing a false mortgage application with a bank.

In July and August 1993, the remaining indicted defendants pleaded guilty to conspiracy to commit mail and wire fraud. Between November 1993 and April 1994, 12 of the managers and salespeople were sentenced. The managers were each sentenced to home confinement of from two to six months, two years’ probation, and fines of from $5,000 to $10,000. The salespeople were each sentenced to terms of one year of probation. The Burkes were sentenced in the summer of 1995. The federal sentencing guideline provisions for Jim Burke provided an imprisonment range of 57–71 months, supervised release, fines, and restitution. The federal sentencing guideline provisions for Monica Burke provided an imprisonment range of 15–21 months, supervised release, fines, and restitution.

While I may at times disagree with the court on a sentencing disposition, I respect the process and the court. What happened in the sentencing of the Burkes reinforced that premise for me but also surprised me. Prior to sentencing, Jim Burke gave an emotional apology and an impassioned plea for leniency for both himself and his wife for their criminal actions. It seemed genuine and resonated with the judge. I thought that the federal judge would take a year off the sentence, leaving Burke to serve about five years in prison. But I was wrong. The judge sentenced Jim Burke to six months of home confinement, three years of probation, a $50,000 fine, and no restitution. The lack of any restitution to victims surprised me the most given the sheer number of victims and fraud loss. Monica Burke received a sentence of one year probation and no restitution to victims.

**Special Circumstances and Additional Fraud**

While boiler room schemes are quite common, what was unique in this case was the size of the operation in terms of employees (well over 100), the large number of victims (over 70,000) and the amount of the fraud (more than $14 million).

In addition, after the initial search warrants were executed, the defendants resumed their criminal activities as if nothing had happened.

During the investigation, the Burkes’ estate, under construction in Mill Neck, New York, burned to the ground on January 5, 1992, in what is an unsolved arson. This was the same location that was searched on August 8, 1991. The Burkes submitted an insurance claim for the fire, and when the insurance company agreed to pay the claim, the U.S. Attorney’s Office, using civil forfeiture laws, seized the $1.3 million insurance payment on the grounds that the money had been obtained through fraud.
In January 1989, Monica Burke reported to Allstate Insurance Company that a limousine registered to her had been broken into and personal property had been stolen. While the limousine had actually been vandalized, nothing was stolen. Still, the Burkes decided to submit a fraudulent insurance claim. To verify the loss, Jim and Monica Burke submitted to Allstate false invoices and receipts for the items allegedly stolen. Allstate subsequently paid the claim. The Burkes each pleaded to a count of mail fraud for this fraudulent insurance claim.

In September 1984, Jim Burke submitted an application to the postal service for his business, American Sales and Marketing Institute (ASMI), to mail at special third-class rates. In the application, Burke described the company as a not-for-profit company engaged in educational activities. Burke received the permit based on this representation and was able to mail at the reduced rates reserved for nonprofit organizations. It was subsequently learned as part of this investigation that Burke’s company was not nonprofit and that the application he submitted was false. Burke defrauded the U.S. Postal Service of over $100,000 through this fraudulent scheme and admitted to this crime as part of his plea.

Jim Burke also engaged in a scheme to defraud employees of his company by purporting to provide them with health-care insurance. Burke informed his employees that they would be provided health-care insurance by Blue Cross/Blue Shield. While the cost of the health insurance was deducted from employees’ salaries, the premium payments for the coverage were not paid to the insurer by Burke. The scheme came to light when an employee was hospitalized and discovered that he had no health insurance.

Burke’s Who’s Who operation spawned dozens of copycat scams. The multitude of salespeople and managers who worked at the various Who’s Who locations learned from the master on how to operate a boiler room operation. Companies similar to the business model of Burke’s operation sprang up all over the New York metropolitan area. Some tried to be legitimate businesses, learning from the lessons of the Burke prosecution and removing fraudulent claims from their pitches. Others were similar in nature to Burke’s operation with misrepresentations and falsehoods that resulted in customer complaints and eventual prosecutions.*

Postscript

Burke subsequently wrote in an unpublished manuscript about his criminal behavior and the impact it had on him and his family. It was an effort to do some soul searching and explain to others how his ego and arrogance had led to personal, reputational, and financial wreckage. Burke wrote that he closed his eyes to his criminal activities and rationalized his fraudulent conduct. He explained that he felt immortal because initially he got away with committing crimes. It wasn’t until he got caught that he finally realized he was a bum, a dope, and, most of all, a felon.

* The names of the individuals mentioned in this case study have been changed.
Review Questions

1. What was a strategy used in Jim Burke’s directory scam?
   A. Telling victims they were chosen to appear in the premier directory
   B. Contacting only upper level executives to appeal to inflated egos
   C. Concluding the initial phone interview by telling the victim he or she would be contacted if approved
   D. Claiming the victim was nominated by a third party for inclusion rather than found on a mailing list

2. What did salespeople do if victims questioned the validity of the offer?
   A. Respond with arrogance
   B. Explain that the directories were regularly purchased by and generally available in libraries
   C. Refer to false information about the directories’ closing, printing and shipping dates
   D. Provide false information about the number of different directories in print
Review Answers

1. A. Incorrect. Telling victims they were chosen to appear in the premier directory was not a strategy in Jim Burke’s directory scam. Instead, the directories were pitched as well-established publications.
   B. Incorrect. Contacting only upper level executives to appeal to inflated egos was not a strategy in Jim Burke’s directory scam. Instead, call lists often included names of middle management and lower level employees.
   C. Incorrect. Concluding the initial phone interview by telling the victim he or she would be contacted if approved was not a strategy in Jim Burke’s directory scam. Instead, at the conclusion of the questioning, the salesperson told the victim either he qualified to be included or would be recommended for inclusion in the directory.
   D. Correct. Claiming the victim was nominated by a third party for inclusion rather than found on a mailing list was a strategy in Jim Burke’s directory scam.

2. A. Correct. If questioned about the validity of the offer, salespeople responded with arrogance and pretended to be offended by the very thought that he or she was trying to sell a fraudulent product.
   B. Incorrect. If questioned about the validity of the offer, salespeople did not explain that the directories were regularly purchased by and generally available in libraries. Rather, this is a common sales pitch used to secure an order.
   C. Incorrect. If questioned about the validity of the offer, salespeople did not refer to false information regarding the directories’ closing, printing and shipping dates. Instead, this false information was provided as part of a sales pitch.
   D. Incorrect. If questioned about the validity of the offer, salespeople did not provide false information about the number of different directories in print. Rather, this is a common sales pitch used to secure orders.
Chapter 12
Kids and Coins: Scoundrels Without a Conscience

Learning Objectives

- Determine what air-bagging is
- Identify a warning sign of charity fraud
- Spot a control measure for detecting charity fraud

Introduction

Some cases just shock the soul and bring into question just how low people can go in defrauding the trusting and the unsuspecting. The faces of fraud can take only so much until even they are ashamed for the evil they perpetrate. That is what I found in an appalling fraud case I investigated. The fraudsters in this case used a defunct children’s charity as a front for the sale of rare coins and fundraising in the name of police officers. In the process they defrauded individuals who believed they were contributing to a charity doing important work on behalf of children. They also defrauded financial institutions that provided the organization with merchant accounts to deposit the credit card payments received from contributors and customers.

The defendants in this case operated two different fraudulent schemes at the same time and location. Kid Watch, which was also known as the American Child Protective Association, purported to be a charitable organization that helped prevent the exploitation of children and assisted families in finding missing children. Metro Rarities purported to offer gold and silver numismatic coins for sale to individuals throughout the United States. Both schemes operated in a boiler room atmosphere with numerous fraudulent representations and promises.

In reality, Kid Watch was not a charitable organization and did not provide the services promised including helping parents with missing, abused, and runaway children. Money that was raised was kept by the operators of this scheme. Metro Rarities misrepresented the quality of the merchandise sold, failed to fill orders, failed to make refunds for returned merchandise, and charged unauthorized purchases to customers’ credit card accounts.

As the then U.S. attorney for the Eastern District of New York said at the time of the arrests, “If our allegations prove to be true, the four [individuals arrested] signify a new low for confidence men in the United States.” I commented in the media that “They didn’t care about missing or abused children; all they cared about was money.”

Genesis of the Fraud

Kid Watch was founded in 1985 by Dennis Kuhn and Nelson Ziegler as a not-for-profit charitable organization. It was first located in Hauppauge, New York, and later moved to Ronkonkoma, New York. Its mission was “to minimize and, where possible, eliminate any and all forms of exploitation directed towards children.” Rodney McCabe was the Director of Operations for Kid Watch.

During its first two years of operation, Kid Watch had limited success in raising funds. In 1987, Ziegler left Kid Watch and by 1989, the organization had substantially ceased delivering charitable services. Kuhn also owned several other companies including a construction company, an aircraft parts company, and an alarm company. All these businesses were located at the same address in Ronkonkoma. Kid Watch had a credit card merchant account since 1985 with minimal activity of less than $1,000 per year until 1989 when the deposited amounts increased.

Suffolk Rare Coin Exchange (SRCE) was in the business of buying and selling gold and silver coins to and from coin collectors and investors. SRCE was located in Medford, New York, and did much of its business through telemarketing. Keith Costello was the owner of SRCE and it operated from June 1988 to August 1989. Tony Simmons was a salesman at SRCE. SRCE closed down in part due to complaints from customers that they had not received the coins they had ordered and that they had not received refunds as promised.

In September 1989, Kuhn and Costello became partners and opened Metro Rarities at the same Ronkonkoma, New York location that already housed Kid Watch and Kuhn’s other businesses. Metro Rarities was also in the business of selling rare coins to coin collectors and investors over the telephone and through the U.S. mail. McCabe became director of operations at Metro Rarities in addition to his duties at Kid Watch.

Kuhn and Costello hired Tony Simmons, Hugo Ackerman, and others as telephone salespeople. Ackerman had prior experience telemarketing rare coins and had worked in several coin boiler rooms in New York. Simmons and Ackerman had previously been arrested by postal inspectors on mail and wire fraud charges for defrauding customers in other coin telemarketing operations.

In general, a coin company will obtain the names of potential customers either from another company by buying its lists of customers or from a list broker such as Dun & Bradstreet. Some lists may be of people who have expressed an interest in collecting coins or are high net-worth individuals. In some cases, boiler rooms will maintain “sucker lists” of people who have fallen for deceptive pitches and are likely to fall for them again. Sucker lists are very valuable for their repeat sales potential and scam artists pay a premium for such lists.

Using these lists, salespeople will call potential buyers and attempt to sell them coins. If the individual agrees to make a purchase, the customer will most likely provide a credit card number to the salesperson. Checks and money orders can also be used but they are not as common as credit cards for payment. The salesperson will then complete an order form that lists the customer’s name, address, telephone number, the coins being ordered, the grade of coins, and the credit card information. Salesperson commission was 20 percent at Metro Rarities.

There are many different grades of coins and the value of any particular coin changes from one grade to another. The difference in price can be in the hundreds or thousands of dollars from a low grade to a high grade. Proper grading of coins requires a skilled numismatist, but many victims of coin scams are not skilled numismatists and have no idea of a coin’s true value. There are a number of professional grading services that will evaluate a coin and provide a grade. There are subtle variations between grading services that can further confound coin buyers. All this adds up to an unfortunate opportunity for fraudsters to take advantage of an unsuspecting and inexperienced coin collector.

It is a given that boiler room salespeople go from operation to operation, usually staying with the scams they know and feel comfortable perpetrating. That is generally true with those involved in coin scams. Yet, at times fraudsters will try their hand at other scams where they can make money, and that was the case here. Another given is that most white collar criminals will cooperate when prosecuted and roll over on higher ups and others to gain a sentencing benefit.

**Description of the Fraud Scheme**

From September 1989 to July 1990, Kuhn operated Kid Watch as a fraudulent money-making enterprise, soliciting contributions under false pretenses that the money would be spent to deliver services such as an emotional trauma center that provided individual, group, and peer counseling for abused children, their families, and the families of missing children. Kid Watch also falsely represented to the public that it operated a nationwide Radio Alert Network to help locate missing children. The evidence revealed, however, that Kid Watch offered no charitable services, and certainly did not operate a trauma center or a nationwide Radio Alert Network.

Kid Watch falsely represented to the public that it entered information pertaining to children who registered with Kid Watch into a national database that would be helpful in locating the children if they ever
became missing. Kid Watch also falsely represented to the public that Kid Watch was supported by various well-known individuals and organizations and that such individuals served on its board of directors, were associated with Kid Watch, and endorsed Kid Watch.

Kuhn hired salespeople to engage in a telemarketing campaign to raise money for Kid Watch. The telemarketers were given pitch sheets directing them to tell contributors that the money was being raised for the trauma center, the Radio Alert Network, and the other alleged projects of Kid Watch. In addition, canisters were placed in local stores to collect money for the defunct charity. One such pitch sheet read as follows:

Hi, my name is Denise. I’m calling on behalf of Kid Watch. It’s a Long Island based program for missing and abused children. The reason we are calling you is Kid Watch is trying to expand the program for the children in different ways than they have already and we need your support. Kodak is trying to help Kid Watch out because they really do believe in what we’re doing for children. Kodak is offering their Gold Card for 200 free rolls of film and half price on the developing of each roll. All Kodak asks in return is that you support the Kid Watch program with a small donation of $29.95 which is tax deductible because it is a donation.

Another pitch sheet read:

Hello. This is Cliff Williamson from Kid Watch, a national organization for runaway and abused children. We are surveying people for ways to raise money. Currently, we are looking at the sale of certified rare coins as a way to raise funds. Would you be opposed to answering a few questions for our survey? In return, there is a bonus coupon for your time.

Q. Do you collect or invest in coins? (If answer is no, then ask) If someone could show you how you could profit off of an investment in rare coins, would you entertain the idea? (If not interested, stop here).
Q. Do you prefer gold or silver?
Q. What is the most money you’ve ever invested in any investment?
Q. Would you be opposed to one of our investment advisors contacting you regarding investments in the rare coin market? Find the best time to call, best number to call, verify address.

The subjects in this operation intertwined the coin sales and the charity. As seen in the pitch sheets, salespeople attempted to sway the people they called to invest in rare coins to benefit Kid Watch. Of note, Kodak had no involvement in this scam and was unaware that its name was being used. It is not uncommon for fraudsters to invoke the name of well-known individuals and corporations as being sponsors or business partners. This is done to reassure the buyers that everything is legitimate. As in many fraud schemes, the operators appealed to a victim’s emotions and human nature. This appeal was hard to resist. Who doesn’t want to help find missing children or turn the lives around for abused children?

Metro Rarities did not maintain a large inventory of coins to be sold to customers but instead obtained coins as they were ordered by Metro Rarities’ customers. Metro Rarities obtained a substantial portion of its income by charging customers’ credit card accounts. To charge customers’ credit card accounts, Metro Rarities needed to have the use of a merchant account with a financial institution through which Metro Rarities could deposit credit card charges. Metro Rarities did not initially have its own credit card merchant account. Recognizing that a merchant account was virtually impossible to obtain for a telemarketing business, Kuhn informed the salespeople that he had a merchant account through a not-for-profit organization called Kid Watch and that the account could be used in the coin business.

Beginning in September 1989, Metro Rarities began defrauding its customers as follows. Metro Rarities accepted customers’ orders for coins, charged customers’ credit card accounts, and accepted and de-
posited customers’ checks, but then did not obtain the ordered coins and did not ship the coins to customers; Metro Rarities charged customers’ credit card accounts even though the customers had never ordered coins. This was called airbagging, using the parlance of telephone bandits. When the customers returned the unordered coins, Metro Rarities refused to refund the customers’ money. Metro Rarities charged customers for high-grade coins but shipped lower-grade coins and then refused to credit customers for refunds. The fraudsters would switch out high-quality coins from the marked containers sent to customers and replace them with low-quality coins in those same containers.

The fraudsters also used other types of scams in their operation. They conducted police department fundraising and sold fire and police safety guides. The means and methods employed by members of the conspiracy in defrauding financial institutions were as follows.

Metro Rarities deposited its fraudulently obtained credit card charges in a merchant account maintained in the name of Kid Watch at Key Bank of Southeastern New York. It received credit against these charges within approximately two days. As described in previous chapters, a credit card merchant account is the lifeblood of a telemarketing firm. Credit cards are the usual payment device and the lack of a merchant account would literally put a company out of business.

The fraudulent activity between September 1989 and March 1990 resulted in approximately 750 credit card transactions totaling $457,653 being charged through the Kid Watch merchant account. Almost half of those 750 items, however, were the subject of customers’ complaints, resulting in approximately $236,765 in charge-backs. Between Metro Rarities’ coin sales and Kid Watch donations, the operation brought in a total of $755,254 from September 1989 to July 1990. Aside from operating expenses and undetermined withdrawals, $348,483 went directly into the pockets of the defendants. My task force comprised of postal inspectors and special agents of the U.S. Secret Service investigating this activity was able to determine where most of the money went, and that money went for personal expenses. However, we could not document all the cash that Kid Watch received.

Kuhn was the boss of Metro Rarities and Kid Watch. He controlled the money and made all the critical decisions. As the money boss, however, Kuhn knew that the money coming in from the customers’ credit card charges was being spent on items other than coins and customers’ refunds. The evidence showed that Kuhn had used the money to repair his car and boat, buy a home, pay property taxes in Florida, rent a car on vacation, buy his wife a fur coat, and pay the expenses of his other businesses.

Investigation

My investigation started in January 1990, after the Postal Inspection Service began receiving complaints from customers that they had received coins inferior to those described over the telephone by Metro Rarities’ sales personnel. In addition, victims alleged that their credit cards were charged for unauthorized purchases, that unordered coins were mailed to them, and that they were not given refunds as promised. My experience investigating similar operations told me that the complaints were most likely just the tip of the iceberg in both victim numbers and fraud losses.

At this time, I initiated the task force investigation of Metro Rarities, but this early in the investigation, I did not know of the involvement of Kid Watch in the fraud. Numerous customers of Metro Rarities were interviewed, as were Hugo Ackerman and former employees of Suffolk Rare Coin Exchange.

The victims’ written complaints described the sales pitch as being high pressure where they felt forced into buying coins. They were told the coins were from an estate sale and if they did not make the decision immediately, the coins would be gone. They were told there was a chance to make a lot of money, but they had to move quickly. In many cases the victims never received the ordered coins or found unauthorized credit card charges had been made on their cards.

One victim told us that he conducted prior business with Metro Rarities but that was a long time ago. When he received a recent credit card statement, he saw an unauthorized charge from Metro Rarities in the amount of $1,516. Another victim told me that he never conducted any business with Metro Rarities but that when he received a recent credit card statement, he noticed two unauthorized charges. He also said that he had prior unauthorized credit card charges made by Kid Watch. Another victim told me that
he received unordered coins from Metro Rarities and an unauthorized credit card charge from Kid Watch. Although he complained to Metro Rarities and Kid Watch, he did not receive a credit for the unauthorized charges. Other victims told similar stories.

I presented my evidence to the assistant U.S. attorney on the case, and requested search and arrest warrants; my request was approved. On March 28, 1990, the task force and I executed a search warrant at Metro Rarities and arrested Tony Simmons, Hugo Ackerman, and another salesman on charges of conspiracy, mail fraud, wire fraud, and credit card fraud. Among the evidence seized from the search were financial records, personnel records, coins, sales records, customer files, complaint letters, and other business books and records. This again shows the value of search warrants in criminal investigations.

Shortly after making bail, Ackerman returned to his job at Metro Rarities. He along with Kuhn, Costello, and McCabe continued to defraud the customers of Metro Rarities. The Postal Inspection Service and the Secret Service continued the investigation of Metro Rarities and expanded it to include Kid Watch. This behavior reinforces my Potato Chip Theory of Fraud (as discussed in Chapter 1), that one fraud often leads to another. New victims of Metro Rarities were located and interviewed. Their stories were similar to those of the prior victims. As the investigation continued and, as is usually the case, new information was discovered.

The expanding investigation soon focused on additional schemes to defraud financial institutions. The defendant’s fraudulent activity reached such dimensions that Key Bank, where the Kid Watch merchant account was held, closed the account due to excessive chargebacks and customer complaints. After Key Bank closed the Kid Watch merchant account, the subjects defrauded Peachtree Bankcard by making false and fraudulent representations to Peachtree in order to obtain another merchant account. They then deposited additional fraudulently obtained credit card charges.

After the Kid Watch merchant account was closed, Kuhn met with Nora Dunbar, a sales representative for Peachtree Bankcard, who agreed to assist them in fraudulently obtaining merchant accounts with the First Interstate Bank of South Dakota. The defendants’ concerted efforts resulted in the opening of new merchant accounts for Metro Rarities and Kid Watch. Kuhn and the others continued to fraudulently charge Metro Rarities’ customers’ credit cards using the Peachtree Bankcard merchant account. Excessive chargebacks, however, resulted in Peachtree Bankcard closing down the accounts.

The defendants defrauded Peachtree Bankcard and First Interstate Bank of South Dakota through a fraudulent merchant account application submitted by Dunbar on behalf of Metro Rarities. On its application, Metro Rarities made numerous false representations including that:

- Metro Rarities had been in business for seven years.
- Only 10 percent of Metro Rarities’ sales were conducted over the telephone.
- Only 10 percent of Metro Rarities’ sales were conducted by mail order.
- Metro Rarities was a stamp and coin store.
- European American Bank was Metro Rarities’ previous bank card processor.

Dunbar falsely represented on the Metro Rarities application that she personally inspected Metro Rarities’ premises and that it was a well-established store located in a shopping center. The defendants also defrauded Peachtree Bankcard and the First Interstate Bank of South Dakota through another fraudulent merchant account application submitted by Dunbar on behalf of Kid Watch. On that application, Kid Watch made numerous false representations including that:

- An individual named Chad Tucker, who signed the application on behalf of Kid Watch, was an officer and owner of Kid Watch. Tucker was a Kid Watch salesperson.
- Marine Midland Bank was Kid Watch’s previous bankcard processor.
- Kid Watch owned its premises.
- Kid Watch had no telemarketing activities.
- Kid Watch had been in operation for seven years.

Dunbar also falsely represented on the Kid Watch application that she personally inspected Kid Watch’s premises and that it was located in a shopping center and that Kid Watch owned its offices. To
further assure success, Dunbar told the defendants what to say if the Peachtree Bankcard Credit Department representatives telephoned them to verify the application information. Between April 1990 and July 1990, Metro Rarities charged over 284 credit card transactions totaling approximately $107,105 through the Peachtree Bankcard merchant account. Almost 45 percent of those transactions were charged back.

I learned that the Pennsylvania attorney general was also investigating Kid Watch. Apparently, Kid Watch was conducting charitable solicitations in Pennsylvania and had failed to file a registration statement with the Pennsylvania Department of State. They commenced an investigation, and their findings were presented in a letter dated October 4, 1990. The significant findings of the investigation are as follows:

The purpose of raising money was for (a) retrieving lost and abducted children; (b) conducting educational programs to increase public awareness of abduction and abuse of children; (c) counseling children and parents emotionally affected by the occurrence of such a loss at a trauma center to be established in Scranton; and (d) publishing each donation and advertisement in a journal of supporters listing every contributor.

In the course of these telephone solicitations and through literature developed about Kid Watch mailed to contributors, respondents engaged in conduct violative of [several Pennsylvania state statutes] by making the following misrepresentations or omissions of material fact: (a) that an emotional trauma center existed in New York and the counseling was currently being conducted there, when, in fact, no such facility existed at the time of the solicitations in Pennsylvania; (b) that a trauma center would be established in Pennsylvania when, in fact, no such facility was ever established; (c) that the New York trauma centers were staffed by licensed and qualified counselors, when, in fact, no such facilities existed at the time solicitations were being conducted in Pennsylvania; (d) that an active radio alert network existed when, in fact, a random sample of radio stations involved showed that many stations were not contacted since their initial enrollment and others which received some calls initially, have not had any follow-up contact for at least two years, and some stations contacted were not even aware of the program; (e) that a 24-hour hotline was available to callers when, in fact, often only an answering service responded that was unable to counsel people’s problems or provide information to those callers; (f) that Kid Watch was registered with the Department of State, Bureau of Charitable Organizations to conduct charitable solicitations when, in fact, it never completed the registration as required by the Bureau of Charitable Organizations; (g) that there was a 90% success rate in the recovery of missing children when, in fact, there is nothing to substantiate this claim; (h) that for each donation made, a corresponding ad would be printed in a journal when, in fact, no ads were ever printed; (i) that Sister [name withheld] name was used without her permission to represent that she endorsed the Kid Watch program when, in fact, such was not the case.2

I used this new and corroborating evidence in my investigation.

On July 24, 1990, we executed another search warrant at Metro Rarities and also at Kid Watch. In addition, Kuhn, Costello, McCabe, and Ackerman were arrested on charges of conspiracy, mail fraud, wire fraud, bank fraud, and credit card fraud. Ackerman was also charged with committing crimes while out on bail, since he had already been arrested during the first search warrant and that case was still pending. The fraudster mindset is often one of arrogance and a mistaken belief that they are smarter than the fraud investigators who pursue them. That is until the realization finally sets in that the scammer is in big trouble.

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from his criminal exploits, and his silver tongue is of no use in extricating himself from the predicament. More information about the arrogance mindset can be found in Chapter 7.

Ackerman eventually agreed to testify against his co-conspirators. In his testimony, he stated:

_We sell over the telephone. We buy mailing lists or telephone lists and we call up people usually who have purchased rare coins before and we try to sell them rare coins. We try to get them to purchase through their credit cards. We try to get their credit card number from them. That way, we get immediate cash from the clients. I had been arrested at another company for fraudulently charging peoples’ credit cards. We call it airbagging in the industry. Sometimes we said we had it [coins in inventory] and we’d ship it out immediately; that wasn’t true. We didn’t have the coins in inventory. [Customer complaints] either came through the telephone or people sent letters or there was a third way where they wrote to their bank. [The nature of their complaints was that] they didn’t authorize the charge, they didn’t order the coins, they returned the coins and were not credited, and also they ordered coins and didn’t receive the merchandise. [The typical markup] was anywhere from 200 percent to 300 percent on an average sale._

_I emphasized the fact that we needed to purchase coins and credit people properly, so we could ship out and keep customers and not have money taken out of our bank account from this. I said to him [Kuhn] that we have to purchase more coins. He basically said to me we didn’t have the money in the account to purchase those coins and that would be the same reason we didn’t credit people because we didn’t have the money in our merchant account. I discussed with him [Kuhn] the problem that we were having with the company and charging peoples’ credit cards without authorization, not shipping merchandise to clients, not refunding them money._

**Prosecution**

On December 21, 1990, Hugo Ackerman pleaded guilty to one count of wire fraud and one count of committing crimes on bail for his criminal activities at Metro Rarities. Ackerman also pleaded guilty to one count of mail fraud for his criminal activities at another coin boiler room. He was sentenced to 15 months in prison and three years of probation and was ordered to make restitution.

On February 21, 1991, Dennis Kuhn, Keith Costello, Rodney McCabe, and Nora Dunbar were indicted on conspiracy to commit wire fraud through the Metro Rarities, Kid Watch, and false Peachtree Bankcard applications schemes. Kuhn, Costello, and McCabe were charged in two counts of wire fraud for defrauding Metro Rarities’ customers and three counts of bank fraud for defrauding Key Bank and the First Interstate Bank. Dunbar was charged with two counts of defrauding the First Interstate Bank.

On April 15, 1991, Tony Simmons pleaded guilty to two counts of wire fraud for his criminal activities at Metro Rarities. He was sentenced to four years of probation.

On June 17, 1991, Costello pleaded guilty to all six counts of the indictment. He was sentenced to two years, nine months in prison and three years of probation and was ordered to make restitution. On a more interesting note, Costello decided to break ranks with his co-defendants and plead guilty rather than go to trial. The reason was a pretrial conference that the trial judge held. Defendants, their counsel, the prosecutors, another federal agent on the case, and I all met with the judge in his chambers.

The judge expressed his opinion that the evidence in the case appeared very strong and asked if there was going to be any resolution of the case before the trial started. Costello’s attorney asked the judge for a few minutes to speak with his client privately. Costello and his attorney left the judge’s chambers to speak in the hall, returning after about ten minutes. The defense attorney said that subsequent to speaking with his client and discussing his options, Costello decided to now plead guilty in the hope of putting this chapter of his life behind him. That left three defendants for trial.

The trial of Kuhn, McCabe, and Dunbar commenced on July 8, 1991. The government presented evidence in the form of live witness testimony, stipulations, and physical exhibits. Assistant U.S. attorneys
Karen Popp and Ira Belkin did a masterful job in prosecuting the case. The evidence showed that Kuhn spent the money his operation received for personal items such as a fur coat and Florida vacation. The defense stipulated to the testimony of the defrauded customers and others in the case. It was a smart move, as bringing in victim after victim telling their story of being defrauded would only do more damage to the defendants. We got their testimony in with the stipulation; we did not have to fly in numerous witnesses saving the travel cost; and we were able to speed up the trial. We were also able to introduce the evidence from the Pennsylvania attorney general’s investigation. The government rested on the sixth day of trial. McCabe put on two character witnesses in his defense. Kuhn and Dunbar did not present a defense.

On the third day of deliberations, the jury returned a verdict. Kuhn was found guilty on all counts except one wire fraud count. Dunbar was found guilty on all counts. The jury could not reach a verdict as to McCabe on the conspiracy count and acquitted him on all other counts.

On September 19, 1991, rather than face a new trial, where he would be the lone defendant, McCabe pleaded guilty to one count of mail fraud for his criminal activities at Metro Rarities. He was sentenced to four months of home confinement and four years of probation.

Dunbar was sentenced to four months of home confinement, three years of probation, and a $1,000 fine. Kuhn was sentenced to 51 months in prison and three years of probation and was ordered to make restitution. Kuhn appealed his conviction all the way to the Supreme Court, but when the case finally came before the high court, it refused to hear his appeal. The conviction and the prison sentence stood.

Chad Tucker was later arrested for his involvement in another boiler room operation where he fraudulently claimed he was collecting money on behalf of police and DEA agents.

Special Circumstances

While boiler room schemes are quite common, what was unique in this case was that two different fraud scams occurred simultaneously. The charity scam and the coin scam resulted in financial institution fraud on two banks as well as fraud on numerous individuals. In addition, after the initial search warrant and arrests, the defendants resumed their criminal activities as if nothing had happened.

During the investigation, the government learned that the Suffolk County District Attorney’s Office had conducted an unrelated criminal investigation of Keith Costello for loan sharking and other crimes. In the course of that investigation, a wiretap picked up numerous conversations involving the Kid Watch and Metro Rarities frauds.

During the investigation of Kid Watch and Metro Rarities, Jonas Dillard, a certified public accountant for both companies, lied to the grand jury to protect Kuhn. Dillard was not a subject or target of the investigation at that point, but he was subsequently indicted for perjury. On November 21, 1991, he pleaded guilty to one count of making false statements. He was sentenced to three months’ home confinement, three years of probation, and a $5,000 fine.

While the trial was not exceptionally long, there were over 1,100 trial exhibits presented as evidence by the government. During the investigation of Nora Dunbar, it was learned that she had submitted fraudulent credit card merchant account applications for several other coin boiler rooms on Long Island, New York. The government was prepared to introduce this evidence at trial, but the trial judge did not allow it in as similar act evidence.  

Fraud Prevention

The amount of money lost in this fraud scheme was minimized due to early detection and a robust investigation and prosecution. A criminal conspiracy at various levels allowed this fraud to develop and exist. The following factors provided the motive, opportunity, and environment for the financial institution fraud involved in this case:

- Greed

3 The names of the individuals and some of the companies mentioned in this case study have been changed.
Chapter 12 – Kids and Coins: Scoundrels Without a Conscience

- Prior criminal history of defendants
- Personal motivations of defendants
- Collusion between the operators of the scheme and a financial institution employee
- Poor checks and balances on the part of the financial institutions
- Naiveté of the victim customers
- This scheme involved three elements: a charity fraud, a coin fraud, and a financial institution fraud

Both fraud investigators and consumers need to know the red flags of charity fraud that include:
- The emotional appeal overcomes your good common sense.
- The charity is one you have never heard of before.
- An offer is made to send a person to your home or office to pick up a donation.
- The charity refuses to tell you how the donation is going to be used.
- The charity refuses to tell you how much of the donation goes into the fundraiser’s pocket.

Charity fraud prevention techniques:
- Give to charities you know.
- Check out the ones you have never heard of before giving any money.
- Be suspicious of charities that accept only cash.

Both fraud investigators and consumers need to know the red flags of coin fraud that include:
- The company calling you is located out of state. Boiler rooms typically target victims as far away as possible.
- Boiler room coin salespeople often promise huge profits in numismatics, guarantee low risks, and claim that you must act now.
- Coins sold through boiler rooms are usually overpriced and of poor quality.
- The offer sounds too good to be true.
- Be suspicious when credit card charges are deposited into an account having nothing to do with the company. For example, Metro Rarities’ credit card charges were listed under the name Kid Watch on customers’ bills.
- Unauthorized charges start appearing on your credit card bills.

Coin fraud prevention techniques:
- Don’t purchase coins via telephone or mail unless you have thoroughly investigated the company.
- Have all coins that you purchase graded by a skilled numismatist.
- If you receive coins that you have not ordered, you may legally keep them and you do not have to pay for them.
- Know your rights as a credit card holder, including the charge-back process. A cardholder can dispute a charge on their statement if he or she suspects fraud. Using a credit card allows the cardholder to dispute fraudulent charges.
Review Questions

1. Which of the following is valuable to fraudsters for their repeat sales potential?
   A. Checks and money orders
   B. Credit cards for payment
   C. “Sucker lists”
   D. Canisters

2. What tactic is used to reassure the potential buyer that the product being offered is legitimate?
   A. Air-bagging
   B. Using the name of well-known individuals and corporations as being sponsors or partners
   C. Using an emotional appeal
   D. Pointing out that the call is being made from a different state

3. What is air-bagging?
   A. Defrauding customers by charging their credit cards even though they didn’t place an order
   B. Promising customers huge profits in numismatics
   C. Guaranteeing low risks and high rewards
   D. High-pressure pitch in which customers are told they have to act immediately

4. Which of the following factors contributed to financial institution fraud?
   A. Lack of prior criminal history of defendants
   B. Convincing well-known brands to make contributions
   C. Air-bagging
   D. Poor checks and balances

5. What is a red flag of charity fraud?
   A. Lack of emotional appeal
   B. Well-known charity
   C. Offer to send a person to your home to pick up a donation
   D. Extensive detail explaining how the donation will be used

6. What is a charity fraud prevention technique?
   A. Making sure the caller is from a different state
   B. Investigating charities that accept only cash donations
   C. Preparing to stop payment if you discover the charity does not exist
   D. Making donations based on the emotional appeal

7. What is a red flag of coin fraud?
   A. Unauthorized charges appearing on your credit card bill
   B. Call made locally
   C. Inability to guarantee low risks
   D. Limited time frame of up to 24 hours to make a decision

8. What is a coin fraud prevention technique?
   A. Don’t purchase coins via telephone
   B. Only purchase coins through the mail
   C. Immediately return coins that were not ordered
   D. Ceasing to use credit cards
Review Answers

1. A. Incorrect. Checks and money orders are not valuable to salespeople for their repeat sales potential. Instead, checks and money orders, though not preferred, serve as a payment option.
   B. Incorrect. Credit cards for payment are not valuable to salespeople for their repeat sales potential. Rather, salespeople will most likely attempt to secure a credit card number for completing a sale.
   C. Correct. “Sucker lists” are valuable to fraudsters for their repeat sales potential. Using these lists, salespeople will call victims and attempt to scam them.
   D. Incorrect. Canisters are not valuable to fraudsters for their repeat sales potential. Instead, fraudsters often place canisters throughout a community in an attempt to collect money for a fraudulent charity.

2. A. Incorrect. Airbagging is not a tactic used to reassure the potential buyer that the product being offered is legitimate. Rather, this is the practice of charging customers’ credit cards even though they didn’t place an order.
   B. Correct. Using the name of well-known individuals and corporations as being sponsors or partners is a tactic used to reassure the potential buyer that the product being offered is legitimate.
   C. Incorrect. An emotional appeal is not a tactic used to reassure the potential buyer that the product being offered is legitimate. Instead, in cases of charity fraud, fraudsters will go to great lengths to appeal to the victims’ emotions in securing donations.
   D. Incorrect. Pointing out that the call is being made from a different state is not a tactic used to reassure the potential buyer that the product being offered is legitimate. Instead, this is a red flag of coin fraud.

3. A. Correct. Airbagging is the practice of defrauding customers by charging their credit cards even though they didn’t place and order.
   B. Incorrect. Airbagging is not a sales pitch promising customers huge profits in numismatics. Rather, this is a common red flag of coin fraud.
   C. Incorrect. Airbagging is not a pitch guaranteeing low risks and high rewards. Rather, this is a common appeal used by fraudsters in telemarketing scams.
   D. Incorrect. Airbagging is not a high-pressure pitch in which customers are told they need to act immediately. Rather, this type of high-pressure appeal is common in boiler room scams.

4. A. Incorrect. Lack of prior criminal history of defendants did not provide fraudsters the opportunity to commit fraud against the financial institution. Instead, prior criminal history of the defendants motivated them to commit fraud.
   B. Incorrect. Convincing well-known brands to make contributions is not a factor that contributed to financial institution fraud. Instead, this is a sales tactic to reassure customers the sales call is legal.
   C. Incorrect. Airbagging is not a factor that contributed to financial institution fraud. Instead, airbagging is the process of charging customers for orders they never placed.
   D. Correct. Poor checks and balances provided fraudsters the opportunity to commit fraud against the financial institution.

5. A. Incorrect. Lack of emotional appeal is not a red flag of charity fraud. Instead, fraudsters will always go above and beyond to appeal to the customers’ emotions to secure a donation.
   B. Incorrect. Using a well-known charity is not a red flag of charity fraud. Instead, most fraudsters will solicit donations for unknown charities.
   C. Correct. Offering to send a person to your home to pick up a donation is a red flag of charity fraud.
   D. Incorrect. Extensive detail explaining how the donation will be used is not a red flag of charity fraud. Instead, fraudsters often do not give any details regarding how the donation will be used.
6. **A.** Incorrect. Making sure the caller is from a different state is not a charity fraud prevention technique. Instead, boiler room telemarketers often make calls to people located far away.

   **B. Correct.** Investigating charities that accept only cash donations is a charity fraud prevention technique.

   **C.** Incorrect. Preparing to stop payment if you discover the charity does not exist is not a charity fraud prevention technique. Instead, you should investigate a suspicious charity before making a donation.

   **D.** Incorrect. Making donations based on the emotional appeal is not a charity fraud prevention technique. Rather, an over-the-top emotional appeal is a common boiler room sales pitch.

7. **A. Correct.** Unauthorized charges appearing on your credit card bill is a red flag of coin fraud.

   **B.** Incorrect. A sales call made locally is not a red flag of coin fraud. Rather, boiler room scams typically target victims out of state.

   **C.** Incorrect. An inability to guarantee low risks is not a red flag of coin fraud. Rather, these scams always guarantee low risks and high returns.

   **D.** Incorrect. A limited time frame of up to 24 hours to make a decision is not a red flag of coin fraud. Instead, fraudsters pressure victims by telling them the deal expires by end of day.

8. **A.Correct.** A coin fraud prevention technique is to avoid purchasing coins via the telephone.

   **B.** Incorrect. It is not a coin fraud prevention technique to only purchase coins through the mail. Instead, a prevention technique is to avoid purchasing coins through the mail.

   **C.** Incorrect. Immediately returning coins that were not ordered is not a coin fraud prevention technique. Rather, in some circumstances it is legal to keep coins that were not ordered.

   **D.** Incorrect. Ceasing to use credit cards is not a coin fraud prevention technique. Instead, using a credit card allows the cardholder to dispute fraudulent charges.
Chapter 13
More Tips, Best Practices, and Lessons

Learning Objectives

- Identify the comprehensive learning approach for gaining experience in fighting fraud which combines on-the-job experience, learning from a mentor, and formal training
- Discern what is critical in fraud investigations because it enables investigators to leverage investigative talent and resources

Introduction

Throughout my 40-year career, I have witnessed the behaviors and damaging actions of fraudsters, the impact on their victims, and how best to detect, investigate, and prevent fraud and corruption. In this chapter I provide you with more of my tips, best practices, and lessons from my long career. I also include more case studies and the knowledge gained from those investigations.

Become a Subject Matter Expert

Experience in fighting fraud does not happen overnight. It can take many years, with each new case and type of fraud investigated providing valuable lessons. I recommend the 70/20/10 learning approach. Seventy percent of learning comes from on-the-job experience investigating fraud. Each new case is a great learning experience. Twenty percent comes from learning from others, so find that great teacher and mentor and learn from him or her. Ask questions and incorporate those best practices into your repertoire. Ten percent of learning comes from formal training and certifications. Make sure you receive ongoing training in fraud topics and investigative best practices, whether conducted by your employer or by another organization. Attend professional conferences where you can learn from the best. Become a Certified Fraud Examiner or Certified Compliance and Ethics Professional. I made both certifications a requirement for members of my Financial Integrity Unit at Microsoft.

Become a subject matter expert (SME) in the detection, investigation, and prevention of fraud and corruption. Investigate as many types of frauds as possible, and learn as much as you can. You can learn from those around you, whether the outcome of their investigation was successful or not. While you will learn much from other SMEs, you can also learn what not to do from those who do not have the drive and ambition to be the very best. Be persistent and never give up. Be thorough with attention to details. Use your imagination as detailed in Chapter 3, and make yourself lucky with your instincts and experience as detailed in Chapter 4. Be patient as fraud investigations can take time, but the time is well spent with great results. I spent six years investigating a major insurance fraud conspiracy, but the results were exceptional. Patience pays off as you learned in Chapter 5.

Teamwork is critical in fraud investigations, especially large and complex ones. Leverage investigative talent and resources, as this is critical to your success. My most complex fraud investigations, both when I was in law enforcement and in the corporate sector, used many subject matter experts. Once you become that SME, go further and become a thought leader, mentoring and developing the next generation of fraud detection and prevention professionals. Fraud will always be a part of our society and in my opinion will only increase in its occurrence in the years ahead. Being prepared is essential to fight fraud. Your knowledge, skills, and abilities will make you successful and help to reduce the impact of this evil.
Documents, Documents, and More Documents

As a fraud investigator, I love documents whether they are in paper or electronic form. The more the better, because I know that the more I have, the better chance that one or more of those documents will help prove my fraud case. When I was in law enforcement I loved search warrants. They would yield multiple boxes and file cabinets full of paper documents to review. From that review, I often found the smoking guns that made my case. I remember one search warrant I executed in Brooklyn, New York. An informant told me that our suspects had moved their business records to the basement of a run-down home in order to hide them from us and from possible seizure by the government. I obtained a search warrant and found 800 boxes in the basement just as the informant said. While examining that large number of documents was a daunting task, once completed I found powerful evidence that helped convict the defendants.

Once you get documents, continually go back and review them as the investigation progresses. On many occasions, I would look at a document and it would have no significance to me because the investigation was in its early stages, and I had yet to learn everything possible about the fraud. As my investigation progressed, the previously reviewed documents made more sense and I found smoking-gun evidence. In one of my cases, the fraudsters used secret codes and markings on their documents to conceal bribes and kickbacks. It wasn’t until I flipped one of the defendants and he explained what the codes meant that the documents had any significance. Remember, if you don’t look, you’ll never find.

Don’t ignore e-mail. E-mail review is an amazing investigative resource. With the abundance of computers today both in businesses and in homes, we find substantial evidence in employees’ e-mails and on their hard drives. In one of my cases, a 10-year employee of a company secretly owned a vendor business that provided services to his company. He never disclosed to his employer that he owned the vendor company or that it was a conflict of interest, as he was required to do by his company’s code of conduct. Over the years he made millions of dollars from his secret ownership. The business conduct violation wasn’t uncovered until an e-mail review found evidence of the company’s ownership. Once confronted, the employee confessed and he was fired. Although there was no evidence that any fraud was involved in the transactions, it was a clear violation of the company’s code of conduct regarding conflicts of interest.

Almost every investigation I conduct today has a connection to e-mail and electronic data. Companies must have a policy advising employees that their e-mails and other information stored on company computers, mobile devices, external storage devices, and other media are company property and can be viewed at any time. Policies also need to be in place that detail approvals for review by designated company personnel while conducting internal investigations.

Remember the Boy Scout Motto

Fraud investigators must always remember the Boy Scout motto: Be prepared. That is especially true in testimony at hearings, depositions, and trials. You must always know your case inside and out and always maintain your composure. Never rush to answer a question in case there is an objection to the question. If you are not sure of the question or need more time to formulate your answer, ask to have it repeated. Anticipate questions from opposing counsel and prepare your responses. Be prepared for every kind of testimony, especially when an attorney violates the rule of never asking a question he or she does not know the answer to. You never know when you will have that once in a lifetime moment.

That is what happened to me in a trial I was involved with in U.S. federal district court on Long Island, New York in 1995. On trial was a self-employed engineer who was hired by various insurance companies to provide his expert opinion on losses in commercial and residential property insurance claims. The engineer would provide his expert estimation of the damage, and that information would be used to determine insurance payment offers to insureds. The engineer was indicted as a result of his collusion with other insurance fraudsters to falsely inflate his expert assessment of the damage at a company, and thus inflate the insurance losses. The engineer received a cash kickback for his fraudulent reporting of damage and for his role in the conspiracy.

I testified at the trial about my informants, and the evidence they provided linking the engineer to the conspiracy. On cross examination, the defense attorney asked me how I was so sure of the credibility of
the public adjuster on this claim. This public adjuster was a co-conspirator who pleaded guilty, was cooperating with the government, and testified in this trial about the criminal activity of the engineer. The defense attorney suggested that I could not ascertain whether the cooperating informant was being totally truthful in his accusation against the engineer. The attorney opened the door and I drove a truck through it.

I testified that while a lack of candor is always a possibility with informants that was not the case in this instance. I explained how I knew this case better than any other investigation I had conducted in my career and had spent many years on it. I then detailed how this informant had named dozens of co-conspirators that he had committed insurance fraud with over the years. I explained that every one of the suspects that the informant named had pleaded guilty in this very courtroom, and that the only one left was the engineer on trial. The defense attorney tried to stop my testimony, but the court allowed me to finish, and I explained my confidence in the informant’s reliability by the sheer number of people he had identified and who admitted their involvement in insurance fraud.

The defendant engineer was convicted and appealed his conviction to the Second Circuit Court of Appeals. The Court of Appeals upheld the conviction, writing that my “damaging testimony was elicited by defense counsel on cross-examination during questioning that sought to cast doubt on the informant’s credibility.” The Court added, “When Biegelman’s testimony started to take a nasty turn, counsel interposed what may have been an objection. The decision to seek no corrective instruction after Biegelman’s testimony was given, and thereby risk further emphasis on that testimony, is defensible in the circumstances.” The engineer’s conviction was affirmed by the Court of Appeals. My knowledge of the case, my preparation for trial, and my confidence in testifying made an impact on the jury and resulted in the conviction and denial of the appeal.

**Why I Love Liars**

Investigators always hope that when they are interviewing fraudsters, the truth will be told. Experienced investigators having interviewed hundreds or thousands of fraudsters develop successful interviewing skills that can result in admissions of wrongdoing. Yet, that is not always the case. Fraudsters often lie when confronted; that should not come as a surprise. Scammers constantly use deceit and lies in their fraud schemes, so why should we expect anything different when they are being questioned. Their deceptive statements can be used to your advantage. In some instances, a lie is as good as the truth. False exculpatory statements made by fraudsters can be very valuable and advance your fraud examination. That is why I love liars.

False exculpatory statements tend to prove consciousness of guilt and involvement in the fraud. A false exculpatory statement occurs when a subject intentionally makes a statement to demonstrate his or her innocence. When that statement is later discovered to be false, it can be used to constitute circumstantial evidence of consciousness of guilt. Examples of false exculpatory statements could include “I have no involvement in preparing my company’s financial statements, so there is no way I could have cooked the books,” or “I never met that person. I wouldn’t know him if he was standing in front of me,” or “You will never find my fingerprints or handwriting on that check.” These statements could turn out to be false exculpatory statements if you can subsequently prove they are lies.

Federal agents and prosecutors know the value of false exculpatory statements. “False exculpatory statements made by a defendant are admissible to prove circumstantial consciousness of guilt or unlawful intent.” I often used Title 18, U.S. Code, Section 1001, which is the federal false statement statute, to prosecute fraudsters who made false statements to me during the course of interviews. Federal prosecutors used this statute to prosecute Martha Stewart regarding her December 27, 2001, sale of ImClone Systems stock, resulting from insider information she received. Stewart was not charged with insider trading.

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1 United States v. Hershman, 89 F.3rd 826 (2d Cir. 1995).
2 Ibid.
3 United States v. Zang, 703 F.2d 1186, 1191 (10th Cir. 1982).
but instead with conspiracy to make false statements to the Federal Bureau of Investigation, Securities and Exchange Commission, and U.S. Attorney’s Office for the Southern District of New York. As we all know, she was convicted after a jury trial and sentenced to a prison term.

**Fraudsters Love Expense Report Fraud**

I have been investigating expense report fraud for much of my career. In my experience, expense report fraud involving travel and entertainment expenses is the most common fraud scheme that organizations face. In organizations, public, private, or nonprofit, a good percentage of employees travel for business and may have organization-issued credit cards to use in those travels. The most frequently occurring expense report frauds I have investigated over the years include falsely claiming personal expenses as business expenses followed by the claiming of nonexistent expenses to inflate reimbursements.

My first case of expense report fraud involved an employee who created phony receipts to justify the expenses claimed, and the fraud was blatantly obvious. The individual created a fake hotel receipt with a room number that did not exist. The name of the hotel clerk on the receipt was someone who did not work there. The hotel confirmed that the employee did not stay at the hotel, and also established that the hotel rate used on the phony receipt was wrong. Additionally, the hotel receipt was not the type used by the hotel. Fraudster stupidity was evident here. The employee also submitted New York State Thruway toll receipts that showed he left his residence and returned to his residence on the same day contradicting the need for a hotel stay.

Later in my career, I investigated the case of a corporate employee who had a reputation as a high-potential performer. He was a relatively low-level employee at the time, but his excellent performance and results had come to the attention of management. He was deemed to have high potential because it was believed that he had the ability to quickly move up the corporate ladder and possibly become an executive one day. This employee falsified his expense report claiming personal expenses as business expenses. His manager was suspicious when reviewing the expense report and escalated his concern resulting in the investigation.

When the employee was interviewed, the first thing he did was produce a copy of the company’s code of business conduct. The employee put the code in front of me, pointed to it, and said, “Show me where in the code of conduct that it specifically says I cannot falsify my expense report? It doesn’t.” Well, he was right that the code didn’t specifically say those very words. However, it did detail the company’s commitment to ethical business practices and a culture of accountability and integrity in everything they do. The code documented the importance of financial integrity and the truthful and accurate reporting of business transactions and fiscal responsibility in spending the company’s funds. The spirit and intent of the code clearly made expense reporting fraud a violation of policy.

The employee was just an arrogant and pompous person thinking that his outrageous demand and statement would somehow stop the investigation and allow him to return to his job. It didn’t, as his admission of wrongdoing and cavalier approach only made the issue worse for him. He was quickly fired. His high-potential status did not help him retain his job. I have no idea if he learned anything from the experience and changed his attitude and his ways. I hope so, because if not, I am sure he will face similar issues in any future employment.

Some expense report frauds are surprising in how easy they are to detect. I had a case where an employee of a company submitted a motorcycle purchase on her corporate expense report. The motorcycle was a gift for her boyfriend and was clearly not a business-related expense. The shocked manager who received the expense report for review and approval quickly referred it for investigation. When the employee was interviewed, she said that from prior experience she believed her manager did not fully review every expense report and she would be able to get this fraudulent motorcycle expense by him without his noticing it. I do not know what she was thinking at the time, but she was wrong. She was fired and the motorcycle was returned to the dealer.

In another example, I conducted an internal investigation on behalf of a private equity investing firm in the United States. The allegation was that an executive had embezzled funds through the submission of
phony invoices to vendors. My investigation involved the review of disbursement activity and relevant documents and records, a search of the subject’s office, forensic computer analysis, and interviews of knowledgeable individuals, including the subject. The forensic examination of the subject’s computer discovered the fraudulent invoices he created to further this fraud. Knowing that fraudsters often commit other frauds based on opportunity and poor internal controls, I reviewed the subject’s corporate expense reports.

I discovered that he often had submitted significant amounts of personal expenses as business expenses. The client did not do a thorough review of expense reports, and the subject knew that. I interviewed the subject and obtained admissions on all the relevant issues including expense report fraud. I then assisted in the preparation of the fidelity claim in the amount of approximately $900,000.

In reviewing the client’s fidelity policy, I found that the policy covered the cost of internal investigations related to defalcations. The client was unaware of this provision, and as a result of my informing the firm, the insurance company covered the cost of my investigation thus providing additional value to my client. A best practice is to always look for the low-hanging fruits of fraud, and that includes expense reporting fraud.

**San Francisco Metergate**

In February 1978, I was an investigator with the San Francisco District Attorney’s Office when an informant came forward to the San Francisco Police Department’s Intelligence Division and told of a potentially large-scale fraud impacting the City and County of San Francisco. The informant had a close friend who was involved in the fraud, and now that they had a personal falling out, the informant decided to exact revenge by disclosing the crime. The informant revealed that the city meter collectors were skimming coins from the money collected each day from the parking meters in San Francisco. The names and titles of several of the suspects were provided by the informant.

The San Francisco Parking Meter Collection Department was responsible for collecting the coins from each of the city’s parking meters and depositing the proceeds into the appropriate bank accounts established by the city. The staff included parking meter collectors whose responsibility it was to collect the coins from the meters, as well as the managers who supervised the collectors. At the end of each collection day, the collectors and supervisors would sort the collected coins. The supervisors would then deposit the coins into the authorized bank accounts maintained by the City and County of San Francisco.

The Intelligence Division conducted some initial surveillance and took photographs of some of the meter collectors removing coins from the collection boxes and taking the stolen money to their homes. Since this was government corruption that would need eventual prosecution, the District Attorney’s Office was called in to work on the investigation. The Special Prosecutions Unit that I was a member of conducted additional surveillance of the subjects.

We focused on one of the meter collectors who had been named by the informant. This meter collector would spend his shift collecting coins from the meters in his assigned territory. The coins were collected into cylindrical metal tubes that were attached to a wheeled device that allowed the collector to walk from meter to meter collecting the coins. As the cylindrical tubes filled up, he would replace them with empty tubes stored in the back of his van. At the end of the shift, the suspect would drive his government van to his residence rather than return to city hall, where the San Francisco Meter Collection Department was headquartered.

We watched the subject carry the metal tubes containing the coins into his garage and close the door. It was evident from how he was carrying the tubes that they were very heavy. Approximately 20 minutes later the garage door would open and the subject would emerge carrying several metal tubes, whereas before he could only carry one at a time. Clearly, they were now much lighter, and it was probably because he had emptied the coins from them. We photographed this and made a daily report of our observations. The subject left his home and returned to city hall where he would turn in his collections and the van.
While conducting the ongoing surveillance of this subject, we observed him loading a heavy box into his car and driving to an area liquor store. We believed the box contained the stolen coins. The subject brought the box into the store and left without it. It was apparent that the liquor store was exchanging the coins for cash. We decided that the next time this happened we would attempt to witness the transaction by posing as customers buying liquor in the store. We didn’t have to wait more than a few days before the subject once again placed a heavy box in his car and again drove to the liquor store. We decided that if we witnessed the exchange, we would arrest the subject and attempt to flip him to cooperate against the other suspects.

The subject entered the liquor store but did not carry anything in. I went in as a customer and looked at some wine. I saw that the subject was talking with the owner, so I purchased the wine and left. The subject came out of the store with a hand truck and went to his car. He took a heavy box out of the car and loaded it onto the hand truck, then took it into the store. Several investigators and I followed him in, and as he was delivering the box, we arrested him. The box was loaded with coins. We brought the collector back to our office and he admitted his involvement along with that of other co-conspirators. In short order, we arrested almost the entire San Francisco Parking Meter Collection Department.

Our investigation was fairly short in length. The arrests followed a six-week investigation where we used surveillance as a key investigative technique. One collector was alleged to have pocketed a thousand dollars a day, and another collector had a coin counting machine at his home to aid in counting his ill-gotten gains. Besides the coins laundered at the liquor store, coins were deposited in area banks or carried to Reno, Nevada, where they were used at casinos. One collector bought a Ferrari and a Porsche, another bought an apartment building, while a third collector purchased a ranch.

We learned that the staff of the San Francisco Parking Meter Collection Department entered into a conspiracy to defraud the City and County of San Francisco by stealing the coins they collected. The scheme worked in a number of ways. The collectors would bring their collection canisters to the collection depot at the end of the day. There, the collectors and supervisors would sort the coins and remove as much as they each could pocket, literally and figuratively. What was not stolen would be deposited into the official bank accounts.

Many of the collectors devised their own systems for stealing. After collecting coins for a few hours, they would leave their official collection routes and go to their homes where they would open the collection canisters and skim some of the coins. The canisters were not officially sealed and could easily be opened by anyone. Of course, the collectors did not tell their co-conspirators of their extra skimming. Ultimately, 18 defendants were charged with theft. Seven cases were eventually dropped, but the rest pleaded guilty or were convicted after jury trial. The investigation found that coins were stolen over a six-year period and that as much as $3 million was involved. In addition, our investigation found that the Parking Meter Collection Department employees went home at noon each day although they were paid for a full day’s work.

Coming so soon after the Watergate case, it was only natural that this case in San Francisco would garner media attention and get its own “gate” treatment. The scandal was quickly dubbed Metergate and made the front pages of the San Francisco newspapers for almost a week. Headlines such as “$3 Million City Scandal—17 Employees Arrested,” “Metergate Probe Spreads,” “Metergate: An Early Warning,” “Shocking Scandal of Metergate,” and “Metergate Tipoff: How Cops Broke Case” captured the city’s attention.

San Francisco’s Metergate was not the only parking meter scam. In May 1978, Brinks was awarded a contract to collect coins from New York City’s parking meters. The city’s department of finance grew suspicious that coins were being stolen and conducted an investigation. Subsequently, five Brinks’ collectors were arrested and charged with grand larceny. Between 2000 and 2005, two men conspired to steal over $700,000 from parking meters in Syracuse, New York. One of the men was an employee of Loomis Fargo & Company that was hired to collect coins from the meters. Rather than deposit the coins in a city account, the fraudsters stole them and exchanged them for cash at area banks and at a Laundromat.

This case again reinforces the value of informants. The team approach using surveillance allowed for a fast investigation. Investigators obtained video evidence of the meter collectors taking the coin canisters
to their homes. The suspects were confronted with the evidence and they confessed, resulting in a successful investigation.

**Yellow Pages Invoice Scam**

Beginning in August 1989, I conducted an investigation involving solicitations in the guise of bills, invoices, or statements of account. Specifically, businesses throughout the country received via U.S. mail, a solicitation for services that looked like an invoice from the local Yellow Pages. My experience as a postal inspector made me aware that as part of a fraud scheme, fraudsters often send out solicitations that look like invoices. Businesses that receive these solicitations mistakenly believe that they are invoices for services they have previously ordered or requested from legitimate companies, and are now due for payment.

In the course of my investigation, I obtained many of these phony invoices. The invoice was yellow in color and was addressed to a specific business. The invoice read “Local Yellow Pages, Attention please detach stub and return with payment to include your listing(s) in the next directory, publication deadline September 8, 1989, please return promptly with payment, make check payable to: Local Yellow Pages, Payment Center, Inc., PO Box X, Lynbrook, New York 11563.” I do not need to remind you that in 1989 people found the addresses and telephone numbers of businesses by checking the Yellow Pages. Internet searches and online directories were far in the future.

Each invoice listed the same invoice number. The amount due was always $97. On the bottom of one portion of the invoice was the following: “This is a solicitation for the order of services and not a bill, invoice, or statement of account due. You are under no obligation to make payment on account of this offer unless you accept this offer.” There was no telephone number on the invoice. The invoices contained the familiar walking Yellow Pages fingers logo we have come to see on their directories. The fraudsters knew that this little touch provided realism to the invoices along with the other markings, yellow color, and wording.

I was in contact with complainants who received the local Yellow Pages invoices but who did not pay them when they realized they were really solicitations. I also interviewed complainants who believed that the solicitation was a real invoice for their legitimate local Yellow Pages and that payment was due. The victims did not notice the disclaimer stating that the invoice was a solicitation for services and not a bill. Each of the victims sent $97 to the same post office box address listed on the invoice. None of the victims ever received the local Yellow Pages Book for which they paid. No one who requested a refund ever received one. The fraudsters were prosecuted and convicted.

These Yellow Pages invoice scams are still common today using the mail and telephone as vehicles to contact victims. While the distribution of hardcopy Yellow Pages directories has been dramatically reduced with online directories, this has not impacted the occurrence of these fraudulent solicitations. Fraud investigators need to be familiar with all the many fraud schemes so they can quickly detect, investigate, and prevent them.

**Best Laid Plans of Mice and Men Often Go Awry**

As well as you may plan and execute your fraud investigation, there is always the potential for bumps in the road. It is inevitable and can run the gamut from minor issues to case-ending implications. Sometimes there is nothing you can do; things just occur. As the character Forrest Gump said in the movie of the same name, “Life was like a box of chocolates. You never know what you’re gonna get.”

That is exactly what I faced in the 1986 trial of a defendant involved in credit card fraud. The defendant was a teller at a branch of Chemical Bank (now part of JPMorgan Chase & Company) in New York City. The teller processed cash advances on fraudulently obtained Visa and MasterCard credit cards. From January 1985 through June 1985, he processed 50 cash advances totaling $61,000 against unauthorized Visa and MasterCard credit cards. The defendant was also involved in submitting fraudulent credit card applications to banks and credit card issuers.

I had an airtight case with all manner of evidence. I had positive handwriting results on the credit card application forms proving he completed the applications, a report from the defendant’s own handwriting
expert agreeing with the government’s finding, evidence taken from his residence via a search warrant, and even his confession to a bank investigator working with me on the case.

Better yet, once the defendant realized that the trail was not going well for him, he jumped bail and fled the country. Once he got home to his native Nigeria, he sent a telegram to the judge advising him that he had returned to Nigeria. The judge told the jury that the defendant had jumped bail and even read the telegram aloud to the court. The telegram dated January 8, 1986, from Lagos, Nigeria, read, “Embar-rassed by unjust prosecution, decided to return home finally on mother’s advice, sorry for inconve- nience.”

The defense attorney told the prosecutor that the jury would be out no longer than 30 minutes and would come back with a conviction. But they came back several hours later with an acquittal on all counts. We couldn’t believe this. This was the prosecutor’s first trial and he was devastated. He wanted to quit his job. I spoke to the jury, and it was clear that they “misremembered”—as former baseball great Roger Clemens likes to say—the evidence presented and the instructions for deliberations given by the judge. The jury thought they had to agree to convict on all of the indictment counts, and if not, they must acquit, which they did. One never knows what a jury will do, although I am a firm believer in the jury system. Juries most often get things right, but one should always be prepared for the unexpected.
Review Questions

1. Which of the following is most effective for gaining experience in fraud?
   A. 70/20/10 learning approach
   B. SME
   C. Teamwork
   D. Becoming a thought leader
Review Answers

1. A. **Correct.** The 70/20/10 learning approach is most effective for gaining experience in fraud. This approach is seventy percent on-the-job experience investigating fraud, twenty percent learning from others, and ten percent from formal training.

   B. Incorrect. SME is not the most effective for gaining experience in fraud. Rather, you should choose the most effective learning approach to become a Subject Matter Expert.

   C. Incorrect. Teamwork is not most effective for gaining experience in fraud. Rather, teamwork is critical in fraud investigations. By leveraging investigative talent and resources, investigators provide diverse subject matter experts.

   D. Incorrect. Becoming a thought leader is not most effective for gaining experience in fraud. Rather, this is a goal of gaining experience in fraud.
Chapter 14
Power of Prosecution and Prevention

Learning Objectives
- Determine what most often discourages fraudsters from committing fraud
- Recognize an activity that improves compliance with an organization’s Code of Conduct

Introduction

The power of prosecution is not to be underestimated. Prosecutions, convictions, and the resulting prison sentences are a deterrent to fraud. As a law enforcement officer, I arrested over 700 fraudsters. Some were career criminals who thought nothing of ripping off people and companies again and again. After completing their prison sentences, some went right back to their fraudster ways. I often arrested these defendants multiple times. I knew that convictions and prison did not necessarily stop future crimes, but it took the fraudster off the street temporarily. That alone had a preventative effect for victims.

The good news for society is that most fraudsters are not repeat offenders. Most of the fraudsters I investigated were onetime opportunists. As long as they got away with what they did, they were fine with their actions. But once I put handcuffs on their wrists and took them to court, the realization set in that they were about to be held accountable. I know that in many of my cases, the arrest and prosecution of first-time offenders caused them to reassess their actions and their lives. They had their motives, opportunities, and rationalizations and that led them to commit fraud. More often than not, those fraudsters learned their lessons and never committed fraud again.

In the mid-1980s, I arrested a young man for credit card fraud. He was fairly arrogant and dismissive when I arrested him, but that soon faded when we fingerprinted, photographed, and processed him for his court appearance and he learned that he was facing jail time. He ultimately decided to accept responsibility for his actions and pleaded guilty and was sentenced to 18 months in prison. Several years later, my team members and I were eating lunch at a restaurant when a young man approached our table. I recognized him as the defendant I arrested for credit card fraud. Now out of jail, he approached us and asked to speak to me. Not knowing exactly what he wanted, I was suspicious and my team members were thinking the worst.

The man said that he wanted to thank me for arresting him. That was not something I usually heard from someone I had arrested and prosecuted. He said that when he saw me in the restaurant, he had to come over to tell me what he had been thinking about for a long time. He went on to say that his arrest and time in prison were turning points in his life because he realized that his crimes impacted his victims, his family, his friends, and himself.

Had it not been for the arrest, he feared that he would have gotten more and more involved in fraud and other crimes. In prison he saw inmates who were unable to change and he had no doubt they would continue their lives of crime once they returned to society. He vowed that would not be him. He was able to reflect on his life and made a commitment to be a better person once he got out. The man explained that he went back to school and now had a job and a better vision for life, and that is why he wanted to thank me.

This was a humbling moment and one I would never forget. This is the ideal outcome that we hope for when a fraudster, or any criminal for that matter, completes the criminal justice process and returns as a productive member of society. Yet, we would be naïve to believe that prosecution alone will stop fraud. Bernard Madoff was sentenced to 150 years for his $20 billion Ponzi scheme. Former Texas tycoon R. Allen Stanford received 110 years for his $7 billion Ponzi scheme. These extraordinarily long prison sentences should deter others, but that is not always the case. In the few years since these investment fraud
cases hit the media spotlight, we have witnessed the discovery and prosecutions of dozens of other significantly large Ponzi schemes.

In my career as a state, local, and federal criminal investigator, I wanted to arrest every fraudster I could find. Although I arrested a good number of them, that did not stop the spread of fraud. There was always a new crop of fraudsters popping up to replace the ones we put in prison, in addition to the serial fraudsters who returned to their crimes once their prison terms were completed. There were never enough law enforcement officers to arrest all the criminals out there. Even if there were enough resources to put every schemer in jail, the damaging effects of fraud would not be reversed, nor would lost assets or reputations be restored. It became apparent that detecting fraud early, or better yet, stopping it from occurring, was far more effective. I learned early in my career the value of fraud prevention and early detection. However, stopping fraud’s feeding frenzy is easier said than done.

Human nature and greed guarantee that society will always face the issue of fraud. It may be noble to try to stop all fraud but the reality is that it will always be present. Still, there is much that can be done to limit its effects. The keys to preventing fraud are, first, to understand that fraud exists, how it rears its ugly head, and then limit the potential for harm. To do this, the early detection of fraud is paramount, along with exceptional fraud prevention programs. To accomplish this, both individual consumers and business organizations need to be accountable for fraud prevention efforts.

**Fraud Prevention for Individuals**

Consumers face a myriad of schemes and scams on a daily basis: investment frauds, charity scams, work-at-home schemes, pyramid schemes, credit card fraud, identity theft, advance fee loan rip-offs, foreign lotteries, and many, many more. Fraudsters target individuals hoping that gullibility and the promise of something too good to be true will overcome simple common sense. Fraudsters will even target specific demographics, such as the unemployed or the elderly, as there is a greater chance that the targets would believe their story or are down on their luck and want a chance to hit it big.

I have said this for most of my 40-year career, but it needs continuous reinforcement. Each of us must be accountable for fraud prevention and limiting the opportunity to be scammed. Law enforcement, government agencies, and consumer groups provide great information on how to recognize fraud schemes. Learning these red flags is paramount. Stopping fraud before it occurs is our goal, and while that may be impossible to totally achieve, there is much we can do to not fall victim. Education and awareness are important tools to embrace and use in fighting fraud.

The faces of fraud can be very convincing. As I said in Chapter 1, fraudsters are silver-tongued devils who will say and do anything so convincingly that victims easily fall prey. As just stated, the elderly are especially vulnerable. A MetLife study found that financial scams cost the elderly $2.9 billion in 2010, up from $2.6 billion in 2008.1 “Some of these financial scams by strangers can be ones that actually deplete the entire life savings of a senior at the worst possible time of their life,” said the president of a nonprofit investor protection organization.2 Fighting elder fraud with more training and resources, as well as coordination and collaboration among responsible parties is critical.

In an excellent example of proactive prevention, the Elder Investment Fraud and Financial Exploitation (EIFFE) Prevention Program was created in November 2010. This program realized that caregivers and local health-care professionals can be a first-line of defense in protecting the elderly from fraud. As the EIFFE press release stated, “The unprecedented effort will educate thousands of U.S. medical professionals about how to spot older Americans who may be particularly vulnerable to investment fraud abuse and then to refer these at-risk patients to state securities regulators and adult services professionals.”3

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1 Christine Dugas, “Elderly Suffer as Financial Abuse Grows,” USA Today, August 16, 2012, 3B.
2 Ibid.
is the kind of effective training that can do much to help identify possible victims, while empowering health-care professionals as fraud fighters. We need to create more of these robust and innovative fraud prevention programs.

**Fraud Prevention for Business Organizations**

Business organizations also need to be accountable for fraud prevention in their companies. The ACFE’s *Fraud Examiners Manual* states that “Fraud prevention requires a system of rules, which, in their aggregate, minimize the likelihood of fraud occurring while maximizing the possibility of detecting any fraudulent activity that may transpire. The potential of being caught most often persuades likely perpetrators not to commit the fraud. Because of this principle, the existence of a thorough control system is essential to fraud prevention.” The key words here are in the last two sentences. The “potential of being caught” and “the existence of a thorough control system” are critical to any effective fraud prevention program. It is about being proactive rather than reactive. As the important elements of a fraud prevention program are discussed within a company, repetition and reinforcement with employees are necessary because they are so critical to the success of a program.

Fraud prevention is much more than just a good business practice; it is a requirement today. Companies face a number of risks, each of which is huge and potentially devastating. Among these risks, the issue of vicarious liability stands out. Corporations and other organizations can be held liable for criminal acts committed as a matter of organizational policy. They may also be held liable for the criminal acts of their employees, if those acts are performed in the course and scope of their employment, for the purpose of benefiting the corporation. An organization can be held liable for something an employee does on behalf of the organization even if the employee is not authorized to perform that act.

The financial risks from fraud losses, shareholders’ lawsuits, federal prosecution, fines, and convictions for fraud are all good reasons to institute a strong fraud prevention program. Risk to reputations and the emotional toll of fraud should also be considered. As hard as it is to believe now, Arthur Andersen once had a sterling reputation among accounting firms. If Arthur Andersen, the founder, were alive today, he would be devastated to see what happened to the company that he spent the better part of his life building into an accounting and consulting powerhouse.

The sad fact is that it takes just a handful of employees to destroy a company of many thousands of innocent individuals. The emotional toll of fraud has an impact on the employees and families who had nothing to do with their company’s fraud, but who suffer the consequences. The personal devastation to the Enron employees, who believed in their company and were deceived like all the other shareholders, is but one example. These employees saw their jobs, life savings, and retirement plans disappear, all because of corporate fraudsters with no integrity.

It should come as no surprise to business executives or managers that a heightened awareness of fraud and fraud prevention is critical to an organization’s success. Implementing enhanced corporate governance requirements is just the beginning of a culture of compliance. A true commitment that begins at the top and incorporates all the elements of an effective compliance and ethics program, can greatly lessen and even prevent fraud.

Organizations can also send an important signal to employees, shareholders, and the government that they take fraud detection and prevention very seriously by hiring former federal agents and prosecutors for their internal investigation and legal departments who have experience investigating and prosecuting fraud and white collar crime. Smart companies know that by bringing in fraud detection and prevention talent, they are improving their compliance programs and lessening their fraud risk. Apply my fraud theories including the Potato Chip Theory, the Low-Hanging Fruit Theory, and the others for fraud and abuse mitigation.

The *Federal Sentencing Guidelines for Organizations* recommends the continuous monitoring, auditing, and evaluating of compliance program effectiveness. The periodic review and revision of corporate governance requirements is just the beginning of a culture of compliance.

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compliance programs is something the Department of Justice and the Securities and Exchange Commission look for when determining possible penalties in enforcement actions. Ongoing evaluation includes the assessment of policies and procedures; anonymous and confidential reporting mechanisms for business conduct violations; whistleblower and nonretaliation protections; tone at the top and tone in the middle; effectiveness of training and communication; and other compliance program elements.  

Compliance program innovation and best practices should always be considered. There is an opportunity to improve compliance with an organization’s code of conduct through changes in how certifications are made. Improving the effectiveness of codes of conduct can be beneficial for an organization. Dan Ariely, the author of The (Honest) Truth About Dishonesty conducted experiments on the effectiveness of having people sign certification statements at the end of the document or at the beginning. Almost every code of conduct I have ever seen requires the person to certify his or her compliance with the code at the end of the document.

Ariely’s experiment was focused on people completing mock tax forms, but it is relevant to codes of conduct. Ariely found “that it would be better to have people put their signature at the top of the forms (before they filled in false information) rather than at the bottom (after the lying was done).” Ariely further commented that “reminders of morality—right at the point where people are making a decision—appear to have an outsize effect on behavior.” I think this is a great idea. I would have people sign the code at the top and also at the end certifying and attesting that they have read the code, will comply with the code requirements, and will report any business conduct violations they discover.

### Fraudsters Are the Same Everywhere

When I retired as a federal agent in 2001, I went to work in consulting and corporate investigation roles. As a result, I have traveled the world. Over the years, I have conducted and managed investigations in more than 70 countries. I had the opportunity to see the faces of fraud in country after country. While we may be separated by language, culture, religion, and political beliefs, the behavior of fraudsters is no different whether they are in Brazil, China, Bahrain, Nigeria, or any other country.

The commonality of fraudsters was reinforced for me in one of my first cases in Asia. I had received information alleging that a corporate employee in Japan had taken kickbacks from a vendor. The accusations came to light when someone anonymously posted the details of the kickbacks on an online site. Whoever the unknown source was, he or she had specific details of the kickbacks including the amounts of the payments and the bank account where the payments were deposited. When it came time to interview the subject employee, I knew it would be a challenge. The employee spoke no English and I spoke no Japanese, so I had to employ a translator to assist with the interview.

Interviewing through a translator is never easy, and finding a translator experienced in investigative interviews poses an additional challenge. Even with an experienced translator, the flow of the interview is significantly slowed waiting for the translator to first translate the question and then the answer. You never know if the question asked is translated in the form and substance that you intend. The same goes for the answer. It is not an easy process. I knew that I would be working from a disadvantage, but I had confidence in both my interviewing skills and my reading of body language.

Since the anonymous source identified the bank account where the kickbacks were deposited, I asked the employee to provide his account statements. If the very specific and large deposits were not there, then the allegation was false. If they were, then that was a different matter. I told the employee that if he voluntarily agreed to provide me with his bank statements, we could know for sure. He agreed to my request and brought his bank statements to the interview, except for the statements that covered the dates when the alleged payments were deposited.

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5 Material in this section is adapted from Executive Roadmap to Fraud Prevention and Internal Control: Creating a Culture of Compliance, 2nd ed., by Martin T. Biegelman and Joel T. Bartow (Hoboken, NJ: John Wiley & Sons). Reprinted with permission.


7 Ibid.
I asked the employee why he had omitted certain statements when I had specifically asked for every month; he could provide no answer other than that he forgot to bring them with him. When I confronted him with the possibility that he intentionally left the statements at his home because he knew they would be damaging evidence of his acceptance of kickbacks, he looked down, buried his face in his hands, and kept that position for an extended period of time. Although I spoke no Japanese and he said nothing at that point, his reaction spoke volumes. After that, I was able to obtain a full admission of his business conduct violations and the kickbacks he received. Fraudsters are the same everywhere.

**Fraud Is the Golden Goose for Criminals**

I was a postal inspector/team leader in Los Angeles in the mid-1990s and supervised a team that investigated fraud schemes including health-care fraud. Health-care fraud is the intentional submission of false or misleading information for use in determining the extent of health-care benefits to be paid. Health care isn’t a luxury; it’s a priority for all of us. That is a primary reason why health care is such an attractive target for fraudsters. It’s the golden goose for scammers. Health-care fraud hits everyone including individuals, businesses, and the government, and it hits hard. According to the FBI, health-care fraud costs the United States an estimated $80 billion a year. We can expect this fraud to continue to grow with health-care spending in excess of $2.7 trillion.

Health-care fraudsters include everyone from health-care providers like chiropractors, plastic surgeons, psychiatrists, and acupuncturists to durable medical equipment suppliers, labs, and benefit plan participants. Plastic surgery fraud is one of the most common health-care frauds. Tummy tucks, breast enlargements, liposuction, and nose and eye jobs are generally elective in nature and not medically necessary, and therefore usually not covered by health insurance. Beverly Hills is a major center for cosmetic surgery in the United States, and that is where we found a plastic surgeon with a very successful practice. Fraud helped make him successful.

Our investigation found that this plastic surgeon did not want to turn a potential patient away, even someone who could not afford expensive surgery. In one instance, a mother and father brought their daughter to the doctor for a consultation on a possible nose job. The girl was a high school student who wanted her nose to look like that of a favorite actress. The doctor examined her and discussed the cost of the procedure. The parents balked when told that the surgery was not covered by their insurance. That did not stop this enterprising doctor.

The doctor suggested a story that would make use of the family health insurance. The parents would tell their insurance company that their daughter was a high school gymnast who lost her footing while practicing on the balance beam. The fall caused the girl to hit her face on the balance beam resulting in the broken nose. The doctor said that he would attest to the need for corrective surgery as a result of the fall and broken nose. This way, he explained, the surgery would be covered under the family’s policy and everyone would win. The parents agreed to the deception and the cosmetic surgery was performed.

We learned of this when the girl bragged to her friends how she got the nose job “for free.” One of her friends told her parents, who reported it to law enforcement. We used this information, as well as other health-care fraud evidence, to obtain a search warrant for the doctor’s office and subsequently prosecute him. That was almost 20 years ago, and today we still see this and other kinds of health-care fraud. The FBI, the Department of Justice, the Department of Health and Human Services, and other agencies are aggressively fighting health-care fraud and we can expect that campaign to continue.

The temptation of the golden goose and its promise of riches are hard for many fraudsters to resist. Whether it’s a small-time scam artist defrauding an unsuspecting individual out of his or her money or a sophisticated corporate fraudster stealing millions from the corporate coffers, stopping any kind of fraud is a daunting task. It won’t be accomplished without a strong and continuing commitment from everyone affected by this enormous problem. But, we still need to do a better job of recognizing the red flags of fraud.
It’s Déjà Vu All Over Again

New York Yankee great Yogi Berra was famous for saying, “It’s déjà vu all over again.” I love that quote because it applies so well to fraud. I have opined again and again that we are poor students of history and do not learn from the past when it comes to fraud. We quickly forget the massive schemes and scams that have previously occurred and their associated red flags. Had we remembered, I am certain we would have less fraud.

I was reminded of Yogi’s memorable quote when I read about a $200 million fraud case that made the headlines beginning in July 2012. On Monday, July 9, 2012, Russell Wasendorf, Sr., CEO, chairman of the board, and founder of Peregrine Financial Group, Inc. (PFG) attempted suicide in Cedar Falls, Iowa. PFG is a futures commission merchant that provides brokerage services for its customers. It is regulated by the Commodities Futures Trading Commission (CFTC). Wasendorf was in his car and tried to kill himself by funneling his car’s deadly exhaust fumes inside the car with a hose. He was found unconscious in the car, but he survived the suicide attempt and was rushed to a hospital. Inside the car were both a suicide note and a signed confession admitting to a long-running and large scale fraud scheme. Wasendorf’s signed confession reads in part:

I have committed fraud. For this I feel constant and intense guilt. I am very remorseful that my greatest transgressions have been to my fellow man. Through a scheme using false bank accounts I have been able to embezzle millions of dollars from customer accounts at Peregrine Financial Group, Inc. The forgeries started nearly twenty years ago and have gone undetected until now. I was able to conceal my crime of forgery by being the sole individual with access to the US Bank accounts held by PFG. No one else in the company ever saw an actual US Bank statement. The Bank statements were always delivered directly to me when they arrived in the mail. I made counterfeit statements within a few hours of receiving the actual statements and gave forgeries to the accounting department.

I had no access to additional capital and I was forced into a difficult decision: Should I go out of business or cheat? I guess my ego was too big to admit failure. So I cheated, I falsified the very core of the financial documents of PFG, the Bank Statements. At first I had to make forgeries of both the Firstar Bank Statements and the Harris Bank Statements. When I choose (sic) to close the Harris Account I only had to falsify the Firstar statements. I also made forgeries of official letters and correspondence from the bank, as well as transaction confirmation statements.

Using a combination of Photo Shop (sic), Excel, scanners and both laser and ink jet printers I was able to make very convincing forgeries of nearly (sic) every document that came from the Bank. I could create forgeries very quickly so no one suspected that my forgeries were not the real thing that had just arrived in the mail.

With careful concealment and blunt authority I was able to hide my fraud from others at PFG. PFG grew out of a one man shop, a business I started in the basement of my home. As I added people to the company everyone knew I was the guy in charge. If anyone questioned my authority I would simply point out that I was the sole shareholder. I established rules and procedures as each new situation arose. I ordered that US Bank statements (sic) were to be delivered to me unopened, to make sure no one was able to examine an actual US Bank Statement. I was also the only person with online access to PFG’s account using US Bank’s online portal. On US Bank side, I told representatives at the Bank that I was the only person they should interface with at PFG.

When it became a common practice for Certified Auditors and the Field Auditors of the Regulators to mail Balance Confirmation Forms to Banks and other entities holding customer funds I opened a post office box. The box was originally in the name of Firstar Bank but was eventually changed to US Bank. I put the address “PO Box 706, Cedar...
Falls, IA 50613–0030” on the counterfeit Bank Statements. When the auditors mailed Confirmation Forms to the Bank’s false address, I would intercept the Form, type in the amount I needed to show, forge a Bank Officer’s signature and mail it back to the Regulator or Certified Auditor.

When online Banking became prevalent I learned how to falsify online Bank Statements and the Regulators accepted them without question.9

Immediately upon finding the confession, law enforcement began its investigation. On July 9, 2012, Wasendorf was interviewed in his hospital room and “acknowledged that he wrote the signed statement using a computer at his residence and that the information contained in the statement was true.”9 Wasendorf was arrested by the FBI on July 13, 2012, and charged with making false statements to regulators.

This confession is unusual in its detail of the scheme and the reference to the many red flags of fraud that went unheeded by everyone. There was the lack of segregation of duties. Wasendorf told representatives of US Bank that they should only deal with him. As the sole shareholder there was no one to question his authority and he was accountable to no one. He opened a post office box to provide regulators with falsified bank statements that appeared to have come directly from the bank. These red flags mixed with his huge ego and arrogance spelled trouble.

By all outward appearances, Wasendorf was a very successful businessman. He had real estate properties and other assets all over the country. He owned restaurants, a publishing company, a construction company, and other businesses. He started a real estate firm in Romania. Wasendorf gave $1.4 million to charity over the years. PFG even provided free gourmet breakfasts to its employees. Wasendorf lived the good life and undoubtedly instilled confidence in his customers and employees who were unaware of the fraud scheme. Outward appearances can be intentionally deceiving. Allegedly, Wasendorf’s true face was that of a fraudster.

Beside the red flags included in his written statement, there were others that went unheeded. There were previous enforcement actions by regulators against PFG since 1996 including “inaccurate accounting, insufficient capital and problems with segregating customer money.”10 The National Futures Association filed 31 arbitration disputes from disgruntled customers since 1995. Most of the complaints have come since early 2011, and an additional 38 arbitration disputes were filed with the CFTC.11 In 2011, US Bank notified regulators that Peregrine has almost a $200 million shortfall but there was no follow-up when “regulators subsequently received a fax purporting to show there was no fund discrepancy.”12 It is now believed that Wasendorf sent the fax. Following a page from the Madoff fraud, regulators never questioned why such a large futures merchant as PFG was audited by a one-person firm. The name of the one-person audit firm was included on audit reports filed with regulators.13

There were other red flags. PFG’s brokers used radio commercials “touting the realistic possibility that customers could turn $10,000 into $80,000 or make similar dramatic profits by following Peregrine’s recommendations.”14 This was during the recent tough economic times where interest rates were at historic lows. That alone should have made customers and regulators suspicious. “There also were allegations that an affiliated securities firm employed unregistered brokers and kept inaccurate books.”15

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9 Ibid.
11 Ibid.
12 Ibid.
13 Ibid.
14 Ibid.
Wasendorf was indicted on August 13, 2012, on 31 counts of making false statements to regulators. The indictment “alleges that Wasendorf submitted false financial statements for his company to the U.S. Commodity Futures Trading Commission that overstated the value of PFG’s customer money, which was supposed to be separate from other funds, by at least tens of millions of dollars.”\(^\text{16}\)

Wasendorf subsequently pleaded guilty to lying to regulators, mail fraud, and embezzlement and faces decades in prison. PFG has filed for bankruptcy, and its 24,000 customers did not have access to their funds at the time of this writing. Investigators are searching for the missing funds, but there is a belief that Wasendorf spent the money living a very affluent lifestyle. I imagine that no one saw the face of fraud when they looked at Wasendorf prior to July 9, 2012. But they definitely saw it after that. Unless we learn from past frauds and heed its red flags, Yogi Berra’s quote will be a common refrain and we will continually see the faces of fraud.

### Sadly, Fraud Is Here To Stay

As much as we would like to eradicate fraud from our lives, that is not realistic unless we can truly change society. Fraud is an evil that we will continually encounter. The faces of fraud are in every corner of the world always looking for opportunities to scheme and scam. It is up to individuals and businesses to do a better job of self-policing opportunities that are too good to be true, constantly looking for red flags, and evangelizing fraud prevention.

In this book I have discussed many of my cases, fraud theories, and opinions about fraud and fraudsters. In my work in law enforcement, consulting, and the corporate sector, I witnessed the financial and emotional impact of fraud. I wish that I did not have to conclude my book with the pessimistic comment that fraud is here to stay unless we do a better job of learning its warning signs and embracing prevention. But that is our fate if things stay as they are and we do not escalate our fight against fraud.

I leave you with two very relevant quotes. One quote is from Alan Greenspan, chairman of the Federal Reserve, who said “Any informed borrower is simply less vulnerable to fraud and abuse.” The other quote is from the fictional detective Sherlock Holmes in *The Adventures of the Blanched Soldier* by Sir Arthur Conan Doyle. Holmes correctly said, “I see no more than you, but I have trained myself to notice what I see.”\(^\text{17}\) If only we could listen to Alan Greenspan and be more like Sherlock Holmes.

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Review Questions

1. What is the first step in preventing fraud?
   A. Understanding that fraud exists
   B. Recognizing that most fraudsters are repeat offenders
   C. Understanding that nothing can be done to limit the effects of fraud
   D. Accepting that business organizations alone need to be held accountable for fraud prevention

2. What is most likely to persuade perpetrators not to commit fraud?
   A. The potential of being caught
   B. Financial risk
   C. Federal prosecution
   D. Risk to reputation

3. Which of the following improves compliance with an organization’s code of conduct?
   A. Hiring former federal agents and prosecutors for their internal investigation and legal departments
   B. Potential for the organization to be held liable for criminal acts committed as a matter of organizational policy
   C. Guaranteeing that fraudsters will be convicted
   D. Requiring people to sign certification statements
Review Answers

1. A. Correct. Understanding that fraud exists is the first step in preventing fraud.
   B. Incorrect. Recognizing that most fraudsters are repeat offenders is not the first step in preventing fraud. Rather, most fraudsters are not repeat offenders.
   C. Incorrect. Understanding that nothing can be done to limit the effects of fraud is not the first step in preventing fraud. Rather, although fraud will always exist, there are many techniques and control measures that can be utilized to limit its effects.
   D. Incorrect. Accepting that business organizations alone need to be held accountable for fraud prevention efforts is not the first step in preventing fraud. Instead, both consumers and businesses need to be held accountable.

2. A. Correct. The potential of being caught is most likely to persuade perpetrators not to commit fraud.
   B. Incorrect. Financial risk is not most likely to persuade perpetrators not to commit fraud. Instead, financial risks due to fraud are a good reason to institute a strong fraud prevention program.
   C. Incorrect. Federal prosecution is not most likely to persuade perpetrators not to commit fraud. Instead, this is a valid reason for installing strong fraud prevention measures.
   D. Incorrect. Risk to reputation is not most likely to persuade perpetrators not to commit fraud. Rather, this is a risk that organizations should consider when deciding whether or not to install a fraud prevention program.

3. A. Incorrect. Hiring former federal agents and prosecutors for their internal investigation and legal departments does not improve compliance with an organization’s code of conduct. Instead, this is one strategy for impressing on employees that the organization takes fraud detection and prevention seriously.
   B. Incorrect. Reiterating the potential for the organization to be held liable for criminal acts committed as a matter of organizational policy does not improve compliance with an organization’s code of conduct. Rather, this is one way to impress upon employees and shareholders the importance of fraud prevention measures.
   C. Incorrect. Guaranteeing that fraudsters will be convicted does not improve compliance with an organization’s code of conduct. Rather, it is an effective fraud prevention strategy.
   D. Correct. Requiring people to sign certification statements improves compliance with an organization’s code of conduct.
A

**Airbagging** – To accept customers’ orders for an item and charge the customers’ credit card accounts or deposit customers’ checks, but then the company does not ship the item to customers.

**Arrogance** – Arrogance is often a common denominator among fraudsters. Fraudsters think they are smarter than everyone else. They never think they will get caught or be held accountable for their actions.

**Arson** – The malicious burning of another's house or property, or in some situations, the burning of one’s own house or property, as to collect insurance.

**Association of Certified Fraud Examiners (ACFE)** – The world’s largest anti-fraud organization and premier provider of anti-fraud training and education.

B

**Boiler rooms** – Boiler rooms evolved from bucket shops, and they involve selling a variety of misrepresented products and investments. Boiler rooms are the dark and evil side of telemarketing, and fraudulent pitches and deception are the mainstays of these operations. The scam artists who work in these operations will say and do anything to make a sale.

C

**Circularization** – Involves mailing questionnaires to potential victims of fraudulent operations to learn the details of their experiences and possible misrepresentations.

**Commodities Futures Trading Commission (CFTC)** – An independent agency of the United States government that regulates futures and option markets. The stated mission of the CFTC is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options, and to foster open, competitive, and financially sound futures and option markets.

**Commodity Exchange Act (CEA)** – Prohibits fraudulent conduct in the trading of futures contracts.

**Compliance program** – Systematic procedures instituted by an organization to ensure that the provisions of the regulations imposed by a government agency are being met.

**Con man** – A person who swindles another by means of a confidence trick.

**Confidential informants** – Commonly called CIs, they can be the best thing that ever happened to an investigator and his or her case, because they can provide information and details only known to criminal insiders. They can advance a fraud investigation, lead to a successful conclusion of the case, and make any investigator look like a superstar. They can also lie and deceive, ruin a fraud examination, and destroy one’s reputation, or worse.

**Counterfeit money schemes** – In the 1860s, a rash of swindles erupted, including phony land sales and lottery promotions. Scams continued to flourish in the years after the Civil War, including phony gold mines, watch and jewelry swindles, medical quackery, and investment rackets. Fraudsters developed counterfeit money schemes where they sold articles which were commonly called in the language of the day green articles, green coin, green goods, bills, paper goods, spurious Treasury notes, United States goods, and green cigars. Con men assembled sucker lists containing the names
Glossary

of victims and potential victims and sold them to other con men. These con artists operated throughout the country. They were virtually immune from prosecution because they were usually outside the jurisdiction of local law enforcement and the federal Mail Fraud Statute had not yet been enacted.

**Credit card merchant account** – A credit card merchant account is the lifeblood of a telemarketing firm. Credit cards are the usual payment device and the lack of a merchant account would literally put a company out of business.

**D**

**Dumpster diving** – Looking for evidence in the trash. Dumpster diving, when and where legally allowed, is a valuable investigative tool and best practice that should be considered where applicable.

**E**

**Elder Investment Fraud and Financial Exploitation Prevention Program** – Created in November 2010, this program realized that caregivers and local health-care professionals can be a first line of defense in protecting the elderly from fraud. As the EIFFE press release stated, “The unprecedented effort will educate thousands of U.S. medical professionals about how to spot older Americans who may be particularly vulnerable to investment fraud abuse and then to refer these at-risk patients to state securities regulators and adult services professionals.” This is the kind of effective training that can do much to help identify possible victims, while empowering health-care professionals as fraud fighters. We need to create more of these robust and innovative fraud prevention programs.

**F**

**Factoring of credit card charges** – This type of factoring works as follows: the boiler room makes sales to customers, obtains their credit card information, and writes up the sale on blank credit card sales drafts. The boiler room then sends the sales drafts to the factoring company, which places its company credit card imprint on the sales drafts. The factoring company deposits the completed sales drafts into its bank merchant credit card account, and later withdraws the sales proceeds and returns them, less a commission, to the boiler room. So although the customer places his or her order with the boiler room, all credit card charging and billing is completed through the factoring company. In addition, any background investigation conducted by the merchant bank is on the factoring company and not the boiler room. In the majority of cases, the merchant bank is unaware that factoring is occurring. Most merchant banks do not allow factoring due to the risk of fraud losses. In fact, credit card factoring is a potential form of money laundering. Telemarketing fraud schemes are notorious for using factoring to process fraudulent credit card transactions.

**Fraud Triangle, The** – Dr. Donald Cressey, a famed teacher and pioneer in fraud research and an important fraud expert, developed the Fraud Triangle Theory to explain why people commit fraud. Dr. Cressey came to the conclusion that the propensity for fraud occurred when three critical elements came together: motive, opportunity, and rationalization. Each of these three elements is necessary and interrelated in order for a person to actually commit a fraud. The absence of any one of them would not allow a person to commit a fraud.

**G**

**Gatekeepers** – The critical role of gatekeepers in an organization is to both prevent and detect fraud and abuse. When gatekeepers fail to embrace their unique role, an invitation for misconduct may result.
Glossary

Greed – Excessive or rapacious desire, especially for wealth or possessions.

Green goods swindles – The most common fraud scheme in the late-1800s through the turn of the twentieth century was the green goods swindle. These scams, using several variations, promised top-quality counterfeit money at a discount.

I

Internal control – A process affected by an organization's structure, work and authority flows, people and management information systems, designed to help the organization accomplish specific goals or objectives. It is a means by which an organization's resources are directed, monitored, and measured. It plays an important role in preventing and detecting fraud and protecting the organization's resources, both physical (e.g., machinery and property) and intangible (e.g., reputation or intellectual property such as trademarks).

International Postal Reply Coupon – A coupon that can be exchanged for one or more postage stamps representing the minimum postage for an unregistered priority airmail letter of up to twenty grams sent to another Universal Postal Union (UPU) member country. IRCs are accepted by all UPU member countries. UPU member postal services are obliged to exchange an IRC for postage, but are not obliged to sell them. The purpose of the IRC is to allow a person to send someone in another country a letter, along with the cost of postage for a reply.

K

Kickbacks – A percentage of income given to a person in a position of power or influence as payment for having made the income possible: usually considered improper or unethical.

M

Mail Fraud Statute – The weapon of choice in stopping widespread fraud, and it holds a unique place in the proud tradition of the U.S. Postal Inspection Service. The use of the Mail Fraud Statute, along with other federal antifraud statutes, has continued to be a powerful tool for prosecution of fraudsters.

N

National Clearing Center (NCC) – Was set up as a traditional boiler room operation. It had a low-budget sales office in which banks of telephones were installed and where salespeople worked from scripts called pitch sheets.

P

Pitch – A planned presentation of a product or service designed to initiate and close a sale of the same product or service. A sales pitch is essentially designed to be either an introduction of a product or service to an audience who knows nothing about it or a descriptive expansion of a product or service that an audience has already expressed interest in.

Public adjuster – Someone who represents insured in claims against insurance companies. Public adjusters are licensed professionals who adjust property claims on behalf of insured property owners. They typically work with the insurance company adjusters and other experts to determine a settlement amount to be paid to the insured.
**Glossary**

**R**

**Racketeer Influenced and Corrupt Organizations Act** – Law intended to eradicate organized crime by establishing strong sanctions and forfeiture provisions.

**Recidivism** – A person's return to criminal behavior, usually after having been prosecuted for previous crimes.

**Reloader** – Once an initial sale was made by an opener, a reloader would take over to close the sale. Reloaders were more experienced salespeople and received larger commissions. They were allowed to use a variety of pitches provided by the company, but were also allowed to make up their own pitches. Reloaders called the customers to persuade them to make larger purchases.

**S**

**Subject matter expert** – A subject-matter expert (SME) or domain expert is a person who is an expert in a particular area or topic.

**Sucker lists** – Con men assembled sucker lists containing the names of victims and potential victims and sold them to other con men. People who have fallen for deceptive pitches and are likely to fall for them again. Sucker lists are very valuable for their repeat sales potential and scam artists pay a premium for such lists.

**U**

**Undercover operations** – Being undercover is disguising one's own identity or using an assumed identity for the purposes of gaining the trust of an individual or organization to learn secret information or to gain the trust of targeted individuals in order to gain information or evidence.
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