

**WHITE COLLAR CRIMES:
FRAUD, RECEIVERSHIPS AND BANKRUPTCY**

Presented By:

Eric Sleeper, Esq.

January 15, 2002

**WHITE COLLAR CRIMES:
FRAUD, RECEIVERSHIPS AND BANKRUPTCY**

White collar investigations and prosecutions, both criminal and civil, focus principally on unwinding financial schemes and locating the proceeds of such crimes. These proceeds may be in the form of cash, securities, diverted assets, hidden inventories etc. The investigations typically are done to obtain evidence of wrongdoing for criminal prosecution, or for the purpose of locating assets to satisfy civil judgements.

White collar crime is hardly an insignificant matter.

The most recent studies, going back several years now, show that fraud and related crimes/abuses cost companies and other U.S. organizations more than \$400 billion annually.

It has also been shown that,

- The average organization loses more than \$9 per day per employee to fraud and abuse.
 - The average organization loses about 6% of its total annual revenue to fraud and abuse committed by its own employees.
 - The median loss caused by males is about \$185,000; by females, about \$48,000.
 - The typical perpetrator is a college-educated white male.
 - Men commit nearly 75% of the offenses.
-

- Median losses caused by men are nearly four times those caused by women.
- Losses caused by managers and executives are 16 times greater than those of their non-managerial employees.
- The most costly abuses occur in organizations with less than 100 employees.
- The highest media losses occur in the real estate financing sector.
- Occupational fraud and abuses fall into three main categories: asset misappropriation, fraudulent statements, and bribery and corruption.

Frequently, perpetrated by those operating within the “fraud triangle”: they have (1) an existing financial problem (e.g., overwhelming personal debts, gambling, addictions), (2) a perceived opportunity to be able to get away with the crime, and (3) a personal “rationalization” that the fraud/embezzlement is not really a crime.

It’s happening in your own backyard (if not within your own business):

- Robert Brennan
- Crazy Eddie (Management Fraud/Embezzlement)
- First Interregional (Ponzi Scheme)
- Joseph Semrod (Theft by his personal executive assistant, Darlene Gentry)
- Great Feelings Spa (Consumer Fraud)

DRIVING FORCE

Greed drives most white collar schemes and crimes. In that respect, keep in mind that no one wants to lose what they believe to be theirs (whether its truly theirs or not). At the same time, individuals and entities will go to great lengths to keep what they believe is their things. Keep each of these predicates in mind when considering the lessons of today’s Conference.

WHO IS YOUR ENEMY?

A key element in any white collar investigation is to “know the enemy.” Any of the following may be considered for gathering the appropriate knowledge:

A. Identify the principals and their family members. There are a large number of sources where this information can be obtained, including Choicepoint, Dun & Bradstreet, Lexis/Nexis, annual reports, municipal records (birth, marriage etc.), and internet searches.

B. Credit checks (Trans-Union, Equifax or Experian) including of spouses and other key family members can be another significant source of information. Information on loans, accounts and other information on credit reports can be helpful.

C. Property ownership records and records reflecting any litigation involving the individuals or entity (as either a plaintiff or a defendant), including bankruptcy filings, are useful.

D. Corporate documents, including articles of incorporation and annual reports filed with the Secretary of State may provide helpful information. Look for any and all business affiliations of the principals, spouses or children. Records of assumed names or DBA's should also be checked.

E. The subject's business premises should be physically inspected/observed. Have each location checked including warehouses, lots, offices, factories etc. Are they really there? What activity is observed and at what level? Any suspicious activities?

F. Never underestimate the value of past affiliations. Remember, there is no better witness than an ex-wife, ex-employee or ex-business partner.

FOLLOW THE MONEY TRAIL

In its simplest terms, a key to locating assets is to "follow the money" trail. Yet, while it sounds simple enough, it is typically a challenging task.

Following the money is a task that can be accomplished by most investigators. If they can add, subtract, multiply and divide they can follow the trail. It all largely comes down to persistence and common sense.

In today's business environment nearly all business transactions are a matter of public or private record. Transactions are recorded to protect the rights of the participants in these transactions. These participants can be businesses, individuals, the government(federal, state, local), banks and other lending institutions and creditors.

These records, when properly analyzed, may be the key to unlocking and prosecuting the white collar criminal. Many a white collar criminal is "papered" into successful prosecution. Identifying, locating and seizing hidden assets is a byproduct of this analysis.

UTILIZE THE SUBPOENA POWER

Most importantly, your subject's business records, invoices, purchase orders, bank records, payroll records, accounts payable and accounts receivable records, personnel files, loan records, asset sale or transfer records, payroll tax records, telephone records and federal tax returns, and travel records should be subpoenaed.

An evaluation may be made of the employment history and turnover of "key people." It would not be uncommon for key people to be let go in anticipation of expected investigations or prosecutions. The replacement employee will have little, if any, knowledge of the previous fraudulent activity where assets were hidden and diverted.

Utilizing lead information from credit reports, relevant loan files, credit card statement, telephone records may be subpoenaed. Recent financial statements tendered to lenders may accurately reflect the assets or may be inflated to impress the lender. Any inflated or inaccurate financial information tendered to a lender may be grounds for bringing federal fraud charges. If the statement is accurate, then the subject will have to explain where the assets have gone.

ANALYZE THE FINANCIALS

Financial analysis is a key element of tracing the money, albeit it is likely to be time consuming. Having access to a computer database program like Access or Excel may also be important to doing an effective analysis.

Utilizing subpoenaed bank records, it is possible to analyze cash inflows and outflows from the subject company. This analysis will point to customers of, and suppliers to, the subject company. It will also identify, among other things, employees and other related individuals receiving payments.

The analysis should focus on financial "changes" or trends that occur within the subject company just before or after a key event occurs, such as the filing of a bankruptcy case, the loss of a lawsuit, an ongoing investigation etc. In general, it is likely that reduced cash inflows will be encountered and increased cash outflows which result in a reduction of assets.

Personal bank records may reveal cash inflows from sources which appear to be unrelated to the subject company. These leads need to be explored. It is not uncommon for subjects to set up parallel companies and divert assets and cash flows to them. These "bleed-outs" typically leave behind all the liabilities after transferring the assets. The subject company will wither as the new entity goes forward while creditors are left with little or nothing.

Following the money trail may necessitate analyzing many other bank accounts that are either the source of, or recipient of, funds from the company or its principals. It is not uncommon for a principal of a company to ask for payment from a customer to be made payable to himself/herself or to a "copycat" entity. The customer will know that they have paid in full, but the subject may carry the receivable on his/her books. These funds may show up in a personal bank account or a new account opened for the bleed-out.

Verification of receivables will also help identify fraudulent financial activity. Are the receivables collectible? Has there been any collection activity on certain large receivables? Are they really diversions of assets without consideration? Were large bad debt write-offs taken? What are the practices for the industry? At the same time, verification of payables will determine if your subject is actually dealing with a supplier. The "payee" may actually be the subject, a relative or some other insider. Stratify the payables and see who is receiving the most money. Check the bigger recipients.

Evaluate cash payments. Are all the sales cash sales? Just credit sales? Is this typical for the industry? Is there skimming involved (Crazy Eddie)?

THE OBLIGATORY BANKRUPTCY

In many instances, the subject of your investigation will file bankruptcy to obtain the benefits of the "automatic stay" which allows the subject to delay and buy time. The bankruptcy filing may also allow further time to secrete more assets and conduct new bankruptcy-related frauds and crimes.

Yet it is important to recognize the opportunities presented when a subject enters bankruptcy. First, the filer is compelled by the filing to create evidence against themselves. By filing a petition, schedules and statement of financial affairs, a tremendous amount of information may be provided and they are filed under penalty of perjury. If a debtor fails to file the proper schedules, the bankruptcy may be dismissed and the debtor may once again be fair game.

A bankruptcy trustee can be an invaluable resource in pursuing the target. Under the Bankruptcy Code, a trustee has broad investigatory and avoiding powers which don't exist outside of bankruptcy. A trustee can take control of the debtors' books and records, waive the debtor's attorney-client privilege in a corporate case, and set aside questionable pre-petition transfers of property.

Questioning the debtor at the first meeting of creditors and taking Rule 2004 examinations are effective tools for obtaining testimony under oath. Unlike depositions outside of bankruptcy, these meetings and examinations can be used as "fishing expeditions".

BANKRUPTCY CRIMES AND FRAUD

Not surprisingly, those who commit frauds and white collar crimes outside of bankruptcy may perpetuate them in a bankruptcy setting. Similarly, a bankruptcy case may serve as a forum to engage in previously untried or unavailable crimes. These may include a wide array of financial crimes and schemes, including concealment of assets, false statements, false claims, bribery, destruction or withholding of documents, identity fraud, bust-outs and purposeful serial filings.

Authorities supporting the prosecutions of these actions include federal statutes such as 18 U.S.C. §§152 and 157 as well as the more recently enacted Identity Theft and Assumption Deterrence Act, 18 U.S.C. §1028.

Section 152 was enacted to attempt to cover all the possible methods by which a debtor, or any other person, tries to keep assets from being equitably distributed among creditors. The statute makes it a crime to, among other things, conceal assets, make false statements under penalty of perjury, file false claims, destroy or conceal financial records related to the bankruptcy estate, or to give or take bribes in connection with a bankruptcy case.

Intent is a key element for such fraudulent acts, although it may be demonstrated by circumstantial evidence ("badges of fraud").

Property of the estate is broadly defined (Legal, equitable and nominal interests).

A bankrupt must disclose even the most circumspect property interests -- full disclosure is the catchword.

Typically, concealed asset cases involve specific property items a debtor seeks to avoid having to distribute to creditors or a continuing course of embezzlement through the life of a case -- a particular concern in a Chapter 11 case where a debtor remains in possession ("ordinary course of business" issues).

A second major area addressed by Section 152 deals with the crime of providing false information (in short, lying) including in a petition, schedules, other court pleadings, certifications, verifications or affidavits, or orally while under oath. The statement must have been made under penalty of perjury, about a material fact, and done knowingly and fraudulently.

A typical false statement prosecution often involves the debtor's failure to disclose property interests as well as their making of misleading, untruthful or inaccurate statements. Purposeful omission of material information may also be actionable.

Identity fraud may also fall under the aegis of a false statement/declaration prosecution.

The making of false claims is also subject to prosecution under section 152. Again, the elements of materiality and fraudulent intent play a role here, and a “good faith” filing may be an adequate defense.

Section 152 also seeks to prosecute bribery in a bankruptcy scenario. This commonly arises in asset sale situations in bankruptcy.

Additionally, the section wisely contemplates that those interested in defrauding others will frequently conceal, alter or destroy business records to cover up their crimes -- and makes such acts themselves a crime.

Bust-outs are another type of debtor fraud falling within the ambit of Section 152.

Serial filings may also be actionable.

Section 157, a more recent bankruptcy fraud statute, helps to combat abusive serial filers as well as other bankruptcy abuses. It is a very broad and multi-tentacled statute. Also utilized to combat foreclosure scams.

MAKING A REFERRAL

When making a referral, the best place to begin is with the U.S. Trustee Program. Overall, the U.S. Trustee has strong working relationships with law enforcement. In many judicial districts there are bankruptcy fraud working groups. Members of those groups include, the U.S. Trustee, the U.S. Attorney, FBI, IRS, Postal Inspection Service and other law enforcement agencies. The U.S. Trustee, therefore, can be a good resource on a district’s referral process.

Referrals should be in writing and allegations should be supported with the appropriate documentation. A letter should explain in clear and plain language what crime(s) has been committed. It is important to explain why certain conduct might be criminal in a bankruptcy context. The referral letter should also seek to highlight the harm caused why the conduct is an abuse, and the amount of the loss. The purpose of the referral letter is not only to report the crime, but to persuade law enforcement to dedicate its resources to an investigation and the prosecution of the individuals or entities referred.

THE CRAZY EDDIE EXAMPLE

Note: This article is presented for informational purposes only and is not intended to constitute legal advice. Every case has special circumstances requiring its own analysis by legal counsel. The view expressed herein are personal to the author and do not necessarily represent those of the firm or its clients. All rights reserved.