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# **NEW EFFECTIVENESS MEASURES FOR ORGANIZED CRIME CONTROL EFFORTS: DEVELOPMENT AND EVALUATION**

## **A Handbook of Analytical Procedures for Use in Organized Crime Control Programs**

**By**

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This project was supported by Grant No. 71-153-G, awarded by the National Institute of Law Enforcement and Criminal Justice, Law Enforcement Assistance Administration, U.S. Department of Justice under the Omnibus Crime Control and Safe Streets Act of 1968, as amended. Points of view or opinions stated in this document are those of the authors and do not necessarily represent the official position or policies of the U.S. Department of Justice.

**October 1973**

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## I. INTRODUCTION

This handbook is intended for senior law enforcement officials responsible for planning enforcement strategy, police tactics, and the allocation of enforcement resources. It presents an innovative procedure for identifying changes in organized criminal initiatives and measuring the effectiveness of enforcement methods directed against organized criminal activity. The procedure is intended to supplement conventional intelligence gathering and as a means of reducing its cost and increasing its effectiveness. The proposed procedure has been tested in strategic and tactical applications and has yielded investigative leads and indictments at an extremely promising rate per man-hour of intelligence gathering and evaluation. These tests were conducted jointly with the Wayne County (Michigan) Organized Crime Task Force. Several of the cases discussed are still active cases.

The procedure was developed and tested with support from the National Institute of Law Enforcement and Criminal Justice, Law Enforcement Assistance Administration, U.S. Department of Justice. It will be evident to the experienced professional reader that its effectiveness in a particular application will be reduced when the fact of its use becomes known to the organized criminal community against which it is directed. For this reason this handbook concentrates on displaying the method and provides only a limited number of illustrations. This choice may cause some duplication of effort as enforcement communities in different jurisdictions adapt the procedures to identical applications. It has been made so that this handbook does not serve the criminal community as an extensive catalogue of probable applications.

### A. The Problem

Traditional enforcement intelligence gathering has identified individual criminal acts, organizations, and pending initiatives through informants, surveillance of known suspects, and undercover investigations. Investigative and prosecutorial planning has been based on measures of criminal and enforcement activity that

are ordinarily collected as part of the basic activities of enforcement agencies. Results of enforcement activities are measured in hours of investigative time; number of arrests, indictments, and convictions; amounts of seized contraband and recovered property; and changes in the number of crimes reported to the police. Applied to the forms of organized criminal activity that have been variously described as "rackets" or "syndicated" crime, however, traditional intelligence gathering has proven to be extremely expensive, requiring a great many hours of investigative time per conviction, and measures of effectiveness, other than convictions of major figures, have been difficult to apply.

Ideally, enforcement planning and resource allocation would deal with three levels of information, each increasing in abstraction. The first level of information is *resource inputs*; that is, manpower, equipment, and facilities. This information can be quantified.

The second category of information is outputs of direct program activities which result from allocating available resources. These outputs are usually measured in terms of arrests, indictments, seized contraband, suspects investigated, etc. An output that is rarely measured quantitatively is the quality and timeliness of information obtained on changes in criminal initiatives. Most strategic and tactical planning today is based upon those two types of information.

The third category of information deals with actual *impacts*. What, for example, happens after a given series of arrests, indictments, and convictions? The procedures outlined in this handbook have been developed to help overcome the difficulty in obtaining this type of information. They consist of a series of steps for identifying, gathering, and using information not usually considered in organized crime intelligence gathering, for the most part available from nonconfidential sources. Most of the information utilized through these procedures is published, maintained by government agen-

cies, or otherwise available to the public. Some, though not generally available to the public, can be obtained through the cooperation of trade organizations and private industrial organizations. The indicators developed through these procedures fall into a category between the second category, program activity outputs, and third category, program impact, outlined above. Each of the indicators measures both enforcement activity and the resultant impacts.

This handbook will describe applications of these procedures to develop indicators which lead to successful investigative leads or measure enforcement effectiveness relating to loan sharking, gambling, labor racketeering, pension and welfare plan fraud, infiltration of legitimate business by organized crime, and sale of untaxed cigarettes. Similar procedures applicable to other forms of organized criminal activity are currently being developed and tested for future distribution.

In deciding whether to adopt some or all of these procedures, a law enforcement organization should consider the costs of its existing intelligence gathering related to organized criminal activity and determine whether the results obtained from the time and manpower expenditures described in this package would significantly increase the effectiveness of the existing program at a relatively minor incremental cost or could replace a more burdensome procedure at a considerable saving.

## **B. Program Hypothesis**

The procedures that are reported below are not predicated on any particular community size. They assume a sufficient degree of urbanization to provide organized crime with a market for its specialized services such as high-risk loans, narcotics, gambling, various forms of commercial vice, and corruption. These procedures also assume a community size sufficient to attract the interests of organized crime in profit opportunities in business or labor management, from use of force, other forms of extortion, or corruption of public officials.

Besides being of an appropriate size, the target community for this package should be one in which municipal government either perceives evidence of an existing organized crime presence; e.g., is aware of sales of narcotics or extortion threats or, on the basis of events sug-

gesting such activity nearby, can anticipate that similar activity is underway within the jurisdiction or may be expected in the foreseeable future.

Separate from the issue of size and characteristics of communities for which these procedures are applicable is the basic requirement for the development of indicators of organized crime. The essential law enforcement resource for effective utilization of the procedures described here is not manpower or money, but integrity within the enforcement agency. This is true for two reasons; the first is self-evident. The procedures are designed to facilitate identification of investigative leads that, in turn, must be exploited to identify and obtain incriminatory evidence against significant organized crime figures. Obviously, if the agency is not interested in convicting identified individuals for gambling, extortion, or fraud, there is no purpose in identifying the incidence of a related form of conduct or the individuals engaged in it.

The second reason is that even in the best of circumstances, the procedures described below will not be effective indefinitely. Sooner or later, the organized criminal community will learn of them. When this happens, the data base upon which the analysis depends will be vulnerable to interference from the criminal community. Criminal organizations will be able to change their modes of operation so as to invalidate future data. The suggested procedures, anticipating this, presuppose a continuing program to develop new data bases from which similar analyses can be made. However, if sources within the police agency utilizing the procedures are vulnerable to organized criminal influence, new data bases may be invalidated even before the analyses based on them can begin.

Provided that the requisite degree of integrity exists, the manpower and resources demand required to utilize the procedures described in this package can be very small. An effective test of some of the methods can be made using the part-time efforts of one man. A few of the methods require access to a computer terminal, but given the programs already developed and available, and access to a keypunching capability, the actual computer time needed to complete the analysis is on the order of five hours, and depends primarily on the number



of establishments in the jurisdiction that are being analyzed.

Since it is evident that the procedures described will not be valid indefinitely, it will be necessary for the enforcement agency convinced of their utility to adopt a procedure for developing and testing new indicators to replace them. This function also is one that can be accomplished during brief periodic working sessions of a small planning task force.

### **C. Goals and Objectives**

The overall goal of the proposed procedures is to reduce the influence, scope, and financial resources of organized criminal activity at a lower cost than would otherwise be possible. In working toward that goal, these procedures are intended to achieve a number of interim objectives. First, the procedures should yield investigative leads faster and using less manpower than conventional organized crime intelligence gathering. Second, they should permit detection of organized criminal activity in areas not otherwise known to be infiltrated by organized crime, or give indication of new organized crime initiatives before conventional

confidential sources of information supply such information. Third, the procedures should permit measurement of the effectiveness and consequences of specific actions taken by the law enforcement community to suppress organized criminal activity more accurately than the measures now in use.

### **D. Implementation Procedures**

The following seven case studies describe specific applications of the general hypothesis to individual types of organized criminal activity. The seven areas are: industrial worker loan sharking, labor racketeering and organized criminal infiltration of business, sale and distribution of untaxed cigarettes, illegal off-track betting, business extortion, labor racketeering, and labor union welfare and pension plan fraud.

For each type of organized crime, the following is described: hypothesis and methodological guidelines, summary procedures, case study, implementation of methodology, and monitoring and self-evaluation. The procedures are described in sufficient detail so as to permit their incorporation into local law enforcement efforts.

## II. CASE STUDY: INDUSTRIAL WORKER LOAN SHARKING

### A. Hypothesis and Methodological Guidelines

The large concentration of low- and moderate-income workers at medium- and large-scale manufacturing and warehousing facilities provides the industrial loan shark with a large pool of potential clients. The individual who lends money at usurious rates to industrial workers, although sometimes an independent operator, is more likely one of the following types:

1. A contact man, employed in the plant, who obtains his funds from an organized criminal system;
2. A contact man not employed in the plant, perhaps employed nearby, who obtains his funds from an organized criminal system; and
3. An individual who lends his own funds, but pays into an organized criminal system for the "franchise" to lend money at usurious rates.

Regardless of category, the industrial loan shark so defined typically will be of the same socio-economic background as the people to whom he lends money.

The borrower, the loan shark's "client" or victim, is typically someone who "just gets by" financially and occasionally needs to borrow to pay unexpected expenses or to replace money lost in gambling or spent on drinking or narcotics. The industrial loan shark or his agent stands ready to make a loan, is known to his clients, is aware of his clients' financial needs from day to day, and is available during the working day to make a loan. The loan shark may take an active role in developing his clients by increasing their needs for short-term loans. Whether an acquaintance or a fellow worker, the loan shark may encourage gambling or narcotics use, thereby creating unexpected debts or expenditures. Also, the loan shark may encourage indebtedness through more licit activities, such as drinking after work.

The loan shark is sensitive not only to his client's need for money, but also to the poor financial management or insufficient income giving rise to that need. The loan shark knows that there are many demands on the borrower's salary, and that if the borrower does not repay the loan upon receipt of a pay check, the loan is unlikely to be repaid. To ensure immediate repayment, the industrial loan shark typically runs a check-cashing service for his borrowers and requires them to use this service. He will accept the borrower's endorsed pay check and return to the borrower cash in the amount of the check minus the amount of money owed the loan shark (principal plus interest). To negotiate the check for his own benefit, to convert it to cash or to deposit it in an account, the loan shark must place his own endorsement on the check. The central hypothesis upon which the methodology is based stems from this practice. It is: Second endorsements of payroll checks by individuals not falling within the normal check-cashing categories (discussed below) indicate the existence of loan shark activity, identifies the loan shark or his representative, and his victim.

The procedure for analyzing second endorsements requires that all cancelled payroll checks for several current, consecutive pay periods for single plants or warehouses be examined and that certain categories of second endorsements on employee payroll checks be systematically recorded. Not all second endorsements are indicative of loan sharking, and two guidelines must be applied to eliminate initially the recording of obviously legitimate ones. The second endorsement of an individual with the same surname as the payee of the check is assumed to be that of a relative and therefore legitimate. The second endorsement of a bank or large retail or chain store may also be assumed to be legitimate. For all other second endorsements, all available information shown on the check should be recorded. Complete recording at this point facilitates further investigation and

avoids the necessity of having to reexamine the checks. The information to be recorded should include as much of the following as appears:

1. Name of second endorser.
2. Address of second endorser (if shown).
3. Bank account numbers which can be attributed to the second endorser.
4. Any other identification numbers which can be attributed to the second endorser.
5. Name of bank where check was negotiated.
6. Check number.
7. Dollar amount of the check.
8. Name of payee.
9. Address of payee.
10. Payee's employment I.D. number.
11. Payee's department number.

The second endorsements should then be sorted into three categories which bear differing levels of scrutiny. The first category is that of bars, restaurants, gas stations, and other small businesses. The second category is that of individuals who are not employees of the establishment for which the checks are being examined. This is determined by comparing the names of second endorsers with a list of all employees at the location under examination. The third category is that of individuals who are employees at the location for which the checks are being examined.

The first category, small businesses, is least suggestive of loan sharking operations. The entries in this group are likely to include bars, liquor stores, small grocery stores, and perhaps a few gas stations which are located near the plant or warehouse and which regularly cash large numbers of payroll checks. Low priority is given to this category because it is not uncommon or irregular for a worker to cash his check at any of these types of business establishments. However, they merit some attention as some of these businesses could provide a good cover under which a loan sharking operation can be well-masked and rendered undetectable on the surface. Also, these enterprises could support activities which lead to loan sharking, such as gambling and narcotics.

When small businesses are found to be cashing regularly large numbers of payroll checks, inquiries should be made to determine the ownership of the establishments cashing checks, and to verify the ability of the establishment to

raise legitimately a sufficient amount of cash to cover the dollar amounts of checks regularly cashed. Should a criminal involvement of a business's management be suggested or insufficient financial resources be shown, then industrial loan sharking might be indicated. Further cause for suspicion would arise from seemingly illogical locations. If a business cashing large numbers of checks is distant from the location of the place of work and not convenient to the residence of the employees, then the cashing of checks might also suggest loan sharking activity. If an individual cashed his check consistently at an "inconvenient" location, there may be reason to question his action.

The second category of second endorser is individuals not employed at the location under examination. This is considerably more suggestive of loan sharking than the first category. Unless an individual's second endorsement appears on behalf of a business establishment (e.g., a bartender), the repetitive endorsement by a single individual of a number of payroll checks should be considered suspicious and possibly indicative of loan sharking. If the name of a second endorser appears regularly on the same employee's payroll checks with perhaps some new first endorsers being added and some old dropping out each week, then the identity of the second endorser should be established. Of particular interest are his criminal history and financial status. If the individual does not have sufficient legitimate resources to negotiate the checks he endorses, and if no legitimate reasons for his endorsing these checks can be determined, then there is a strong suspicion that the second endorser so identified is involved in loan sharking.

The third category, that of repetitive second endorsements by individuals employed within the plant under scrutiny, is the most suggestive of industrial loan sharking, as such activity is not typical of workers on modest salaries. (This assertion does not ignore the existence of check-cashing pools and lotteries based upon the check's identification number. These activities are, however, readily identified since they are visible.) Should any employee be found to cash checks totaling even a few hundred dollars consistently over several pay periods, there is strong reason to suspect that he is involved in loan sharking operations, and perhaps either drug trafficking or gambling.

To summarize, the examination of second endorsements can bring an investigation to the point of identifying, with a high degree of assurance, investigative leads on loan sharking operations. The analysis will identify the names of individuals who have been and are currently being victimized by loan sharking and those who are involved in making the loans. Furthermore, by determining if any checks bear the second endorsement of different individuals on different weeks, and if this pattern is consistent among several employees, the analysis may reveal a network among lenders.

This information makes it possible to direct conventional police investigative and surveillance activities with increased precision and reduce the burden of making a sufficient showing of probable cause for support by grand jury examination.

In the course of the investigative phase work, application of the methodology may be continued to identify changes in the loan sharking methods. Changes in the endorsement patterns may indicate that the investigation has been discovered and that the methods of operation are changing or diminishing as a result of that investigation. If, for example, the number of second endorsers decreases significantly, it may be because of an actual decrease in loan sharking or because of implementation of a new loan sharking procedure. Surveillance conducted on loan sharks and victims identified by earlier second endorsement reviews would identify cases, for example, where instead of cashing pay checks himself, the loan shark escorts his victims to a bank where they cash their payroll checks in his presence and immediately make payment to him.

## B. Summary Procedures

1. Obtain the payroll checks of all hourly employees for at least the four most recent consecutive pay periods.
2. Examine the second endorsements appearing on the backs of the checks. If the endorsement is not that of a family member (determine by a comparison of surnames) or of a large and generally well-known business establishment, record the following information:
  - a. Name of second endorser, along with

address and any identification numbers.

- b. Name of bank at which the check was first negotiated.
  - c. Any bank account numbers appearing on the check.
  - d. Dollar amount of the check.
  - e. Check number.
  - f. Name, address, social security number, employee identification number, and department number of the payee of the check.
3. When the second endorser is an individual, determine if he is an employee at the plant for which the checks are being examined.
  4. Group the second endorsers into three categories:
    - a. Individuals employed within the plant.
    - b. Individuals not employed within the plant.
    - c. Businesses.
  5. For each group, summarize and display the data in a way which will facilitate the determination of:
    - a. The number of checks cashed by each second endorser.
    - b. The dollar value of the checks cashed by each second endorser.
    - c. The consistency with which a payee cashed his check with a given second endorser.
    - d. The frequency with which payees cashed their checks with different second endorsers.(Exhibit I shows a format that displays the required information.)
  6. Identify second endorsers who appear *not* to have legitimate reasons for cashing payroll checks based upon following criteria:
    - a. Individuals countersigning checks have proven or suspected criminal records.
    - b. Individuals or businesses do not appear to have legitimate access to sufficient funds for cashing checks.
  7. Utilize conventional investigative procedures to determine relationships among

identified lenders and to exploit channels of access to criminal sources of funds.

8. Implement monitoring systems to identify renewed attempts at industrial worker loan sharking.

The next section describes the application and testing of these steps as part of a local law enforcement effort. The sections that follow it describe the resources required to implement and maintain a methodology to identify industrial loan sharking activities and describe guidelines for monitoring and self-evaluation.

### C. Analysis of Indicators of Industrial Loan Sharking

An investigation of industrial loan sharking, utilizing the techniques described in the summary procedures, was undertaken with the cooperation of the Wayne County Organized Crime Task Force.

Through a personal contact with the vice president for personnel of a major U.S. manufacturing corporation, access was gained to the payroll checks of all hourly employees in two manufacturing plants. One plant is located in the heavy industrial section of a major city and has approximately 450 hourly employees; the other plant is located in an industrial suburb twenty miles from the first plant and has approximately 1100 hourly employees.

The examination of payroll checks was carried out in two phases. In the first phase, names and appropriate identification information of both payees and second endorsers on payroll checks with suspicious second endorsements were recorded. This was done for four consecutive pay periods to identify recurring second endorsers and to determine the consistency with which employees' checks bore the same second endorsement. Employee records were checked to determine whether the recurrent second endorsers were employees at the factory. Conventional financial investigative techniques were utilized to determine whether the second endorsers had sufficient financial resources to support the level of check cashing evidenced by the endorsements.

The second phase consisted of tracing back in time the payroll records of employees on whose checks suspicious second endorsements appeared. This was done to determine the

length of time that these workers had been turning over their checks to possible loan sharks. Perhaps even more important, this historical analysis identifies relationships among the second endorsers. An operational relationship between two second endorsers, possible loan sharks, is assumed if the borrowers turn their pay checks over to either one of two endorsers.

Local law enforcement personnel who, because of limited resources, could initiate only one field investigation at a time, decided that primary attention would be given to the inner-city plant. Consequently, only the first phase of the check examination was carried out for the suburban plant.

An analysis of the patterns of second endorsements for both factories follows, along with a description of the police investigation into loan sharking activities in the inner-city factory.

#### *Inner-City Plant*

In the first phase of the examination of second endorsements, four consecutive pay periods were reviewed. Checks endorsed by large retail stores or banks were eliminated. The names of thirteen individuals appeared as second endorsements on two or more checks in each of the four pay periods. A summary of the data for a typical one-week pay period appears as Exhibit 1.

Second endorsers #2 and #12 were singled out for further investigation because the amount of money they handled was considerably higher than the amounts handled by other second endorsers. A financial investigation initiated through law enforcement channels indicated

**EXHIBIT 1—Summary of Individual Second Endorsees for Typical One-Week Pay Period**

| Second Endorsees | Is Endorsee an Employee? | Number of Checks Cashd | Amount of Money Represented by Checks Cashd |
|------------------|--------------------------|------------------------|---|
| 1                | YES                      | 2                      | \$ 173                                      |
| 2                | YES                      | 29                     | 3,300                                       |
| 3                | NO                       | 2                      | 136   |
| 4                | NO                       | 3                      | 307   |
| 5                | NO                       | 3                      | 162   |
| 6                | NO                       | 3                      | 360   |
| 7                | NO                       | 2                      | 277   |
| 8                | YES                      | 5                      | 584   |
| 9                | NO                       | 3                      | 643   |
| 10               | NO                       | 2                      | 165   |
| 11               | YES                      | 2                      | 360   |
| 12               | NO                       | 24                     | 3,004                                       |
| 13               | YES                      | 5                      | 472   |

that neither of the two individuals had sufficient legitimately held financial resources to engage in the level of check cashing evidenced weekly.

Concurrently, the payroll checks of ten of the "victims" were traced back through 22 pay periods to determine the length of time these individuals had been turning their checks over to possible loan sharks. This analysis also identified the relationships among two or more possible endorsers. Exhibit 2 summarizes the endorsement patterns of these ten employees. It shows that the clientele of the two second endorsers is interchangeable. This interchangeability suggested that if loan sharking was in fact taking place, it was being carried out not by a single individual, but rather by a small organization.

On the basis of the above information, Task Force officials carried out an active police investigation. In March 1972, an undercover police officer was placed in the plant as an hourly employee. He was given a job in the same shift and department of the factory in which one of the suspected loan sharks was employed. He was instructed to make it known that he was in severe financial trouble and that he needed to borrow money. Within a matter of days, one of the suspected loan sharks offered a loan in the amount of \$20. Unfortunately, the officer refused the loan in the hope that a larger loan would be offered. Either because of his failure to take the offered loan or because of his unwillingness to participate in any of the other continually ongoing illegal activities, narcotics and gambling particularly, or to socialize with fellow employees, the officer became suspect and his undercover assignment was terminated. His short-term presence in the plant did, however, validate the belief that loan sharking was going on. Further, he was able to corroborate the identity, gleaned from the second endorsements, of the loan sharks and the borrowers suggested by the second endorsements.

Concurrent with the undercover investigation, a complete criminal and financial check of the second endorsers was made. Second endorser #12 showed a pattern of living and financial worth not at all consistent with her legitimate income. This individual (a woman who is married to a retired former plant employee) had no income tax record and showed no visible

means of support other than social security, but had two unlisted phones, had three cars, and always paid cash for large purchases. Her unexplained income in 1972 was in excess of \$14,000.

EXHIBIT 2.—Summary of Endorsement Patterns of Ten Suspected Loan Shark Victims.

| Pay Period | Borrower No. 1        |       |       |       |                     |
|------------|-----------------------|-------|-------|-------|---------------------|
|            | Second Endorsement by |       |       |       |                     |
|            | No. 12                | No. 2 | No. 8 | Other | Bank or Supermarket |
| 1          | X                     |       |       |       |                     |
| 2          |                       | X     |       |       |                     |
| 3          |                       |       |       |       | X                   |
| 4          | X                     |       |       |       |                     |
| 5          | X                     |       |       |       |                     |
| 6          | X                     |       |       |       |                     |
| 7          |                       | X     |       |       |                     |
| 8          |                       | X     |       |       |                     |
| 9          |                       |       |       |       | X                   |
| 10         |                       | X     |       |       |                     |
| 11         | X                     |       |       |       |                     |
| 12         |                       |       |       |       | X                   |
| 13         |                       | X     |       |       |                     |
| 14         | X                     |       |       |       |                     |
| 15         |                       |       |       | X     |                     |
| 16         | X                     |       |       |       |                     |
| 17         |                       |       | X     |       |                     |
| 18         |                       | X     |       |       |                     |
| 19         |                       | X     |       |       |                     |
| 20         |                       | X     |       |       |                     |
| 21         |                       | X     |       |       |                     |
| 22         |                       |       |       |       | X                   |

| Pay Period | Borrower No. 2        |       |       |       |                     |
|------------|-----------------------|-------|-------|-------|---------------------|
|            | Second Endorsement by |       |       |       |                     |
|            | No. 12                | No. 2 | No. 8 | Other | Bank or Supermarket |
| 1          |                       |       |       |       | X                   |
| 2          |                       | X     |       |       |                     |
| 3          |                       | X     |       |       |                     |
| 4          | X                     |       |       |       |                     |
| 5          |                       | X     |       |       |                     |
| 6          |                       | X     |       |       |                     |
| 7          |                       |       | X     |       |                     |
| 8          |                       |       | X     |       |                     |
| 9          |                       |       | X     |       |                     |
| 10         |                       |       |       |       |                     |
| 11         |                       | X     |       |       |                     |
| 12         |                       |       | X     |       |                     |
| 13         |                       |       | X     |       |                     |
| 14         | X                     |       |       |       |                     |
| 15         | X                     |       |       |       |                     |
| 16         | X                     |       |       |       |                     |
| 17         |                       |       |       | X     |                     |
| 18         |                       | X     |       |       |                     |
| 19         |                       | X     |       |       |                     |
| 20         |                       |       |       |       | X                   |
| 21         |                       | X     |       |       |                     |
| 22         |                       |       |       |       | X                   |

**EXHIBIT 2--Summary of Endorsement Patterns of Ten Suspected Loan Shark Victims--Continued.**

| BORROWER NO. 3 |                       |       |       |       |                     |
|----------------|-----------------------|-------|-------|-------|---------------------|
| Pay Period     | Second Endorsement by |       |       |       | Bank or Supermarket |
|                | No. 12                | No. 2 | No. 8 | Other |                     |
| 1              | X                     |       |       |       |                     |
| 2              | X                     |       |       |       |                     |
| 3              | X                     |       |       |       |                     |
| 4              | X                     |       |       |       |                     |
| 5              | X                     |       |       |       |                     |
| 6              | X                     |       |       |       |                     |
| 7              |                       | X     |       |       |                     |
| 8              | X                     |       |       |       |                     |
| 9              |                       |       |       |       | X                   |
| 10             |                       | X     |       |       |                     |
| 11             |                       | X     |       |       |                     |
| 12             |                       | X     |       |       |                     |
| 13             |                       | X     |       |       |                     |
| 14             |                       | X     |       |       |                     |
| 15             |                       | X     |       |       |                     |
| 16             | X                     |       |       |       |                     |
| 17             |                       |       |       |       | X                   |
| 18             |                       |       |       |       | X                   |
| 19             |                       |       |       |       | X                   |
| 20             |                       |       |       |       | X                   |
| 21             |                       |       |       |       | X                   |
| 22             |                       |       |       |       | X                   |

| BORROWER NO. 5 |                       |       |       |       |                     |
|----------------|-----------------------|-------|-------|-------|---------------------|
| Pay Period     | Second Endorsement by |       |       |       | Bank or Supermarket |
|                | No. 12                | No. 2 | No. 8 | Other |                     |
| 1              |                       |       |       |       | X                   |
| 2              |                       |       |       |       | X                   |
| 3              | X                     |       |       |       |                     |
| 4              |                       |       |       |       | X                   |
| 5              |                       |       |       |       | X                   |
| 6              |                       |       |       |       | X                   |
| 7              | X                     |       |       |       |                     |
| 8              |                       |       |       |       | X                   |
| 9              |                       |       |       |       | X                   |
| 10             | X                     |       |       |       |                     |
| 11             |                       |       |       |       | X                   |
| 12             |                       |       |       |       | X                   |
| 13             |                       |       |       |       | X                   |
| 14             |                       |       |       | X     |                     |
| 15             |                       | X     |       |       |                     |
| 16             |                       |       |       | X     |                     |
| 17             |                       | X     |       |       |                     |
| 18             |                       | X     |       |       |                     |
| 19             |                       | X     |       |       |                     |
| 20             |                       | X     |       |       |                     |
| 21             |                       | X     |       |       |                     |
| 22             |                       |       |       |       | X                   |

| BORROWER NO. 4 |                       |       |       |       |                     |
|----------------|-----------------------|-------|-------|-------|---------------------|
| Pay Period     | Second Endorsement by |       |       |       | Bank or Supermarket |
|                | No. 12                | No. 2 | No. 8 | Other |                     |
| 1              |                       | X     |       |       |                     |
| 2              |                       | X     |       |       |                     |
| 3              |                       | X     |       |       |                     |
| 4              |                       | X     |       |       |                     |
| 5              |                       | X     |       |       |                     |
| 6              |                       | X     |       |       |                     |
| 7              |                       |       |       |       | X                   |
| 8              |                       | X     |       |       |                     |
| 9              |                       |       |       |       | X                   |
| 10             |                       | X     |       |       |                     |
| 11             |                       | X     |       |       |                     |
| 12             |                       | X     |       |       |                     |
| 13             | X                     |       |       |       |                     |
| 14             | X                     |       |       |       |                     |
| 15             | X                     |       |       |       |                     |
| 16             | X                     |       |       |       |                     |
| 17             |                       | X     |       |       |                     |
| 18             |                       | X     |       |       |                     |
| 19             |                       | X     |       |       |                     |
| 20             |                       | X     |       |       |                     |
| 21             |                       | X     |       |       |                     |
| 22             |                       | X     |       |       |                     |

| BORROWER NO. 6 |                       |       |       |       |                     |
|----------------|-----------------------|-------|-------|-------|---------------------|
| Pay Period     | Second Endorsement by |       |       |       | Bank or Supermarket |
|                | No. 12                | No. 2 | No. 8 | Other |                     |
| 1              |                       |       |       | 0     |                     |
| 2              |                       |       |       | ⊗     |                     |
| 3              |                       |       |       | 0     |                     |
| 4              |                       |       |       | ⊗     |                     |
| 5              |                       |       |       | 0     |                     |
| 6              |                       |       |       | ⊗     |                     |
| 7              |                       |       |       | 0     |                     |
| 8              |                       |       |       | ⊗     |                     |
| 9              |                       |       |       |       | X                   |
| 10             |                       |       |       |       | X                   |
| 11             |                       |       |       | 0     |                     |
| 12             |                       |       |       | 0     |                     |
| 13             |                       |       |       | 0     |                     |
| 14             |                       |       |       | ⊗     |                     |
| 15             |                       |       |       | 0     |                     |
| 16             |                       |       |       | ⊗     |                     |
| 17             |                       |       |       | 0     |                     |
| 18             |                       |       |       |       | X                   |
| 19             |                       |       |       | 0     |                     |
| 20             |                       |       |       | ⊗     |                     |
| 21             |                       |       |       | 0     |                     |
| 22             |                       |       |       | ⊗     |                     |

⊗ = Endorsee No. 4  
 0 = Endorsee No. 5

**BORROWER NO. 7**

| Pay Period | Second Endorsement by |       |       |       | Bank or Supermarket |
|------------|-----------------------|-------|-------|-------|---------------------|
|            | No. 12                | No. 2 | No. 8 | Other |                     |
| 1          |                       |       |       |       | X                   |
| 2          |                       |       |       |       |                     |
| 3          |                       | X     |       |       |                     |
| 4          |                       | X     |       |       |                     |
| 5          |                       |       |       |       |                     |
| 6          |                       | X     |       |       |                     |
| 7          |                       |       |       |       | X                   |
| 8          |                       |       |       |       | X                   |
| 9          |                       |       |       |       | X                   |
| 10         |                       | X     |       |       |                     |
| 11         |                       | X     |       |       |                     |
| 12         |                       | X     |       |       |                     |
| 13         |                       |       |       | O     |                     |
| 14         |                       |       |       |       |                     |
| 15         |                       |       | X     |       |                     |
| 16         |                       |       |       |       | X                   |
| 17         |                       | X     |       |       |                     |
| 18         |                       |       |       |       | X                   |
| 19         |                       | X     |       |       |                     |
| 20         |                       |       |       |       | X                   |
| 21         |                       | X     |       |       |                     |
| 22         |                       | X     |       |       |                     |

0 = Endorsee No. 6

**BORROWER NO. 9**

| Pay Period | Second Endorsement by |       |       |       | Bank or Supermarket |
|------------|-----------------------|-------|-------|-------|---------------------|
|            | No. 12                | No. 2 | No. 8 | Other |                     |
| 1          |                       | X     |       |       |                     |
| 2          |                       |       |       |       | X                   |
| 3          |                       |       |       |       | X                   |
| 4          | X                     |       |       |       |                     |
| 5          |                       | X     |       |       |                     |
| 6          |                       |       |       |       | X                   |
| 7          |                       | X     |       |       |                     |
| 8          |                       |       |       |       | X                   |
| 9          |                       |       |       |       | X                   |
| 10         |                       |       |       |       |                     |
| 11         |                       |       | X     |       |                     |
| 12         |                       |       |       |       | X                   |
| 13         | X                     |       |       |       |                     |
| 14         | X                     |       |       |       |                     |
| 15         |                       | X     |       |       |                     |
| 16         |                       | X     |       |       |                     |
| 17         |                       | X     |       |       |                     |
| 18         |                       |       |       |       | X                   |
| 19         |                       | X     |       |       |                     |
| 20         |                       | X     |       |       |                     |
| 21         |                       |       |       |       | X                   |
| 22         |                       |       |       |       | X                   |

**BORROWER NO. 8**

| Pay Period | Second Endorsement by |       |       |       | Bank or Supermarket |
|------------|-----------------------|-------|-------|-------|---------------------|
|            | No. 12                | No. 2 | No. 8 | Other |                     |
| 1          |                       |       |       |       | X                   |
| 2          |                       |       |       |       | X                   |
| 3          |                       |       |       |       | X                   |
| 4          | X                     |       |       |       |                     |
| 5          | X                     |       |       |       |                     |
| 6          | X                     |       |       |       |                     |
| 7          |                       |       |       |       | X                   |
| 8          | X                     |       |       |       |                     |
| 9          |                       |       |       |       | X                   |
| 10         | X                     |       |       |       |                     |
| 11         | X                     |       |       |       |                     |
| 12         |                       |       |       |       | X                   |
| 13         |                       |       |       |       | X                   |
| 14         |                       | X     |       |       |                     |
| 15         |                       |       |       |       | X                   |
| 16         |                       |       |       |       | X                   |
| 17         |                       |       |       |       | X                   |
| 18         |                       |       |       |       | X                   |
| 19         |                       |       |       |       | X                   |
| 20         |                       |       |       |       | X                   |
| 21         |                       | X     |       |       |                     |
| 22         |                       |       |       |       | X                   |

**BORROWER NO. 10**

| Pay Period | Second Endorsement by |       |       |       | Bank or Supermarket |
|------------|-----------------------|-------|-------|-------|---------------------|
|            | No. 12                | No. 2 | No. 8 | Other |                     |
| 1          |                       | X     |       |       |                     |
| 2          |                       |       |       |       | X                   |
| 3          |                       |       |       |       |                     |
| 4          |                       |       |       |       |                     |
| 5          |                       |       |       |       |                     |
| 6          |                       |       |       |       |                     |
| 7          |                       | X     |       |       |                     |
| 8          |                       | X     |       |       |                     |
| 9          |                       |       | X     |       |                     |
| 10         |                       | X     |       |       |                     |
| 11         | X                     |       |       |       |                     |
| 12         |                       | X     |       |       |                     |
| 13         | X                     |       |       |       |                     |
| 14         | X                     |       |       |       |                     |
| 15         |                       | X     |       |       |                     |
| 16         |                       | X     |       |       |                     |
| 17         |                       |       |       |       | X                   |
| 18         |                       |       |       |       | X                   |
| 19         |                       |       |       |       | X                   |
| 20         |                       |       |       |       | X                   |
| 21         |                       |       |       |       | X                   |
| 22         |                       |       |       |       | X                   |



The home of second endorser #12 was placed under surveillance. The analysis of second endorsement patterns had shown that "clients" of second endorsers #2 and #12 would turn their pay checks over to either one of the two possible loan sharks. In other words, the payroll checks of suspected loan shark victims would sometimes be endorsed by second endorser #12 and sometimes #2. The relationship between #12 and #2 was further corroborated when the surveillance team observed a car drive from the residence of second endorser #12 to that of #2. After direct contact between the two was observed, all checks formerly endorsed by second Endorser #12 were thereafter endorsed by #2. Through surveillance, it was also learned that second endorser #12 regularly visited a bonding service that appeared to do little business while maintaining large amounts of cash in checking accounts. The bonding service also was reported to maintain large amounts of cash on hand.

The Task Force objective of this investigation was not primarily to prosecute and jail the industrial loan sharks, but first to determine the relationship between organized crime and industrial worker loan sharking and, second, to identify those people in policy-level positions in the organized crime system. The investigation is continuing and the results will be placed before a grand jury in the near future.

#### Suburban Plant:

Phase I of the analysis of second endorsement patterns was completed for the suburban plant. Pay checks for four consecutive pay periods were examined. Based upon this review of endorsements, the following second endorsers are thought to be of interest for further investigation.

| Second Endorsers | Is Endorser an Employee? | Average Number of Checks Cashd Per Pay Period | Average Amount of Money Represented by Checks Cashd |
|------------------|--------------------------|---|---|
| 1                | NO                       | 13  | \$1,531   |
| 2                | YES                      | 9   | 1,089   |
| 3                | YES                      | 3.5   | 390   |

The second endorsers listed above are all private individuals, none of whom show legitimate financial holdings sufficient to support the level of check cashing evidenced by the recurrent second endorsements. Also, endorsers #2 and #3 have criminal records.

There are also three business establishments within the immediate vicinity of the plant which merit further inquiry. Numbers 4 and 5 below are neighborhood bars, and #6 is a small gas station.

| Second Endorsers | Number of Checks Cashd | Amount of Money Represented by Checks Cashd |
|------------------|------------------------|---|
| 4 (bar)          | 51                     | \$7,093                                     |
| 5 (bar)          | 47                     | 6,558                                       |
| 6 (gas station)  | 7                      | 920   |

In general, it is not unusual or suspicious for a bar to cash a significant number of checks on pay day as a service to customers from neighboring plants. These two bars become a matter of interest, however, for the following reasons. In the case of bar #4, financial records both of the employees and of the corporation do not show sufficient funds to support the level of check cashing that takes place, and the credit reference indicates that the corporation is not able to borrow legitimately each week an amount of money sufficient to support that level. In the case of bar #5, the financial and credit information are analogous to that of bar #4. Furthermore, the owner of the bar has a criminal record of concern. The instance of the gasoline station cashing an average of \$920 weekly is also curious. It is seldom the case that a gas station need provide a check cashing service in order to maintain its clientele. Furthermore, it is unusual today that a station should maintain on hand that amount of cash. The circumstances indicate that these three business establishments should be subject to further investigation.

#### D. Implementation of Methodology

This test investigation had to deal with several problems that new investigations may be they may be dealt with now, are summarized below:

1. Considerable time had to be spent with Task Force officials explaining both the general concepts supporting the development and use of indicators of organized crime and the specific hypotheses having to do with loan sharking. Specifically, a working relationship based upon confidence and trust had to be established, and the Task Force had to understand the risks involved in testing these new

approaches. This effort would not necessarily have to be duplicated as the concept has to a large degree been proven. The degree to which credibility has been established should reduce considerably the time required to explain the utility of this approach.

2. Selection of a corporation where mutual trust and confidence could be developed required some preparation. Corporate officials had to be convinced that participating in this experiment was beneficial. Also, certain corporate resources were required for the analysis, as payroll checks had to be removed from files and taken to a relatively secure office in such a way as to prevent disclosure of the project's purpose and method. The time required for developing these relationships should decrease as the validity of this approach is proven.
3. Inasmuch as corporate files of cancelled checks had not previously been reviewed, requirements for labor and supporting information were not known with any precision. Based upon work completed to date, it is now possible to estimate with some accuracy resource requirements for the analysis.

The initial analysis of the payroll checks at both plants required fifteen man-days of effort of the following people: three attorneys, one certified public accountant, and one auditor from the Task Force; and a political scientist and economist from the project staff. Five of these fifteen man-days were required for policy-level discussions with corporate officers to establish credibility and gain access to payroll checks. Ten man-days of effort were required for the recording of information from the checks, analysis of the information, and identification of possible loan sharks and their victims.

Following this initial analysis, ten man-days were required to determine the financial condition and criminal history of both the possible loan sharks and their victims.

Seven man-days of effort represented the placing of the undercover agent in the plant. Ten man-days of surveillance on selected loan sharks followed the undercover work.

Based upon the information collected, twenty man-days of effort have been devoted to the

preparation of letters inviting loan shark victims for informal questioning by attorneys and investigators, the interrogation of those who answered the letter, the preparation of subpoenas, and the development of grand jury questions.

In summary, an estimate of the time and personnel category required to analyze the payroll checks for 1,500 workers over four pay periods is:

|   | <i>Manpower Requirements</i>                     |
|---|--|
| Step 1—Initial analysis                                   | 4-5 man-days of a trained clerk                  |
| Step 2—Identification of possible loan sharks and victims | 2 man-days of a clerk, 1-5 man-days investigator |
| Step 3—Confirmation of loan shark/victim relationship     | 1-? man-days of police investigators             |

It is not possible here to identify with any precision the manpower requirements of police investigators and attorneys after suspected loan sharks and victims are identified, as this would vary according to size and incidence of the loan sharking operation identified and the priorities of local law enforcement officials. What is important, however, is that only 6-7 man-days of clerk-time and 1-5 man-days of investigator time *at maximum* are required before decisions are made to allocate scarce and expensive police and prosecutor time.

This analysis could require even fewer law enforcement resources if businessmen themselves were to analyze, at least on a sample basis, second endorsers. The encouragement of this activity would have to be based upon local conditions. If this information could be gathered for a number of plants and warehouses in varying sizes in a single jurisdiction simultaneously, the likelihood of obtaining useful information before the criminal community learns of the method would be increased.

#### E. Monitoring and Self-evaluation

Eventually, these procedures should result in either a reduction in loan sharking or a change in the method of operation by loan sharks. In order to monitor these changes, payrolls should be rechecked periodically where loan shark second endorsers have been replaced by other second endorsers. These successors should be evaluated. If the new second endorsers are scattered throughout the city or are neighbors

of the payee, he may be no longer a loan shark victim.

If the new second endorsers are banks in the neighborhood of the plant, the loan shark may be accompanying his victim to the bank to collect as soon as the employee cashes his check. Surveillance will determine whether a loan shark is escorting his victims to the bank.

To evaluate the success of a loan shark suppression program after the criminal community has learned to avoid double endorsements, it will be necessary to monitor other indicators of change. Productivity increases in sections where

there were a number of loan shark victims may indicate the removal of loan shark pressures and the associated time requirements.

A decline in losses or thefts of valuable tools and materials would also indicate that the number of loan shark victims has decreased.

Self-evaluation and monitoring, in many cases, may not require the direct commitment of law enforcement beyond generally advising businessmen. This dual function, then, might be built into business procedures, and any suspicious trends or aberrations reported to law enforcement officials.

### III. CASE STUDY: LABOR RACKETEERING AND ORGANIZED CRIMINAL INFILTRATION OF BUSINESS

#### A. Hypothesis and Methodological Guidelines

Continued analysis of the annual reports of labor unions and their respective pension and welfare plans may help to identify shifts in the scope and incidence of organized crime. One set of indicators developed and tested analyzed the way in which unions and plans utilize their assets. One of the specific hypotheses tested was that shifts in portfolios from secured assets (e.g., mortgages and government bonds) to unsecured assets (e.g., signature loans and notes) may be indicative of organized criminal influence. Such influence might ultimately result in a union or plan losing assets due to default on loans. The existence of unsecured loans is hypothesized to be cause for further investigation into the union's or plan's management practices.

There are, however, reasons other than default of loans due to criminal activity for examining the assets of labor unions and their pension and welfare plans. Certain unsecured loans to businesses by unions already dominated by criminal influence may identify preliminary attempts by criminal interests to take over legitimate business. The hypothesis here is that a note or loan signed by a business, with no lien against any assets, may represent the preliminary attempt by organized crime to infiltrate that business because a business with assets would prefer the lower interest rate to be associated with a secured transaction.

If a businessman needs cash to pay either legally or illegally incurred debts, and he is unable to pay them through legitimate sources, he may approach (or be approached by) criminal interests who agree to make a loan on the businessman's signature. In situations where the debt was incurred through illegal or irregular practices, such as gambling or investment in speculative ventures, the businessman may prefer the high-interest unsecured loan to avoid drawing notice to the indebtedness by filing

liens. In these cases, the businessman does not want his partners and colleagues and those who hold equity in the company to know of the loan, and as they would not approve of the loan, none of the company's assets is formally pledged as collateral. However, the note will be treated by the lender as a loan to the company, not the individual.

The holder of the note, the lender, may want to appear to be legitimate. If so, the signed note may be listed as an asset in a portfolio, as it would reflect an increase in asset growth. This would certainly be the case where the lending agent has a constituency which, at least in a peripheral sense, is concerned with asset growth. Brokers, investment banks, and welfare and pension plan trustees are in this category. Although the lender or its agent is willing to list the loan as an asset, the borrower may not be so interested in acknowledging the loan as a liability. Acknowledging that the loan had been made would expose him to his colleagues, principals, and family.

Examination of discrepancies between selected lenders' listings of assets and borrowers' recorded liabilities, then, is postulated as a means to identify preliminary criminal efforts to infiltrate legitimate business. If the businessman cannot pay the loan, he may be forced to surreptitiously turn over certain business operations to criminal interests.

This form of takeover has both logical and historical bases. To summarize some of the above points, a businessman obtains money from criminal sources when he is unable to obtain a loan from legitimate sources. As a preliminary move to take over the business, criminal interests will lend the money to the businessman as a company officer, and take his note or I.O.U. The lender, when it desires to appear legitimate, lists this note as an asset since its constituency or clientele is concerned with portfolio growth. Also, to make the note appear to have intrinsic worth, although unsecured, it is

identified as being a note backed up by the businessman's company.

This note, however, is never recorded as a company liability by the company. After the note is signed, pressure is then put on the businessman to pay. When he can't, alternatives are offered by the lenders which may include obtaining an interest in the company, using the company as a front for illegal operations, using the company's credit rating fraudulently, and so on. Cases of criminal takeover of legitimate businesses are familiar, but they are usually not discovered until after a considerable time period over which the company's assets have been depleted or the businessman has been physically threatened. The relationship suggested by the lender listing the note as an asset and the businessman not listing the note as a liability seldom is recognized before the business takeover.

Unsecured loans made by unions and welfare and pension plans can be readily identified by examining their annual reports filed with the U.S. Department of Labor. The liabilities of businesses can often be obtained through commercial credit bureaus. Any major discrepancy between the lender acknowledging a note as an asset and the borrower acknowledging it as a liability is cause for further investigation.

## B. Summary Procedures

Listed below are the procedural steps for utilizing the indicator described above:

1. List the unsecured loans made to businessmen by labor unions and their welfare and pension plans as these appear on the unions' or plans' annual reports.
2. Obtain from commercial credit bureaus the credit rating of the identified business, and determine whether the loan is listed as a liability.
3. Where the loan is not listed as a liability, consider the circumstance an investigative lead to organized criminal activity.
  - a. Examine tax records of the business or businessman;
  - b. Conduct conventional investigation to determine criminal influence on borrowers; and
  - c. Conduct investigation of the lender.

The next section describes the application and testing of these steps as part of a local law enforcement effort. The following sections identify the resources required to implement and maintain a methodology to identify this type of criminal activity and describe guidelines for monitoring and self-evaluation.

## C. Analysis of Indicators of Labor Racketeering and Organized Criminal Infiltration of Business

An investigation of the relationship between labor racketeering and organized criminal infiltration of business was undertaken with the Wayne County Organized Crime Task Force. The preliminary aspects of this investigation proceeded quickly as the analysis of labor union and pension and welfare plans had been completed and working relationships with a commercial credit bureau established.

In one of the pension plans examined, assets were composed primarily of unsecured loans, the breakdown being:

| Year | % Assets in Unsecured Loans             |
|------|---|
| 1966 | 93.4                                    |
| 1967 | 76.1                                    |
| 1968 | 88.9                                    |
| 1969 | 53.6 (estimated with only partial data) |

In 1968, unsecured loans were over \$10 million. In 1969, they were more than \$4 million.

One of these listed assets is a \$50,000 payable-on-demand note *signed* by an officer of a middle-sized light industrial operation. The note states that money was loaned to the business on the officer's signature. The union does not represent any employees who are employed by this company. The note, then, is listed as a pension plan asset.

A review of a commercial credit analysis of the company did not reveal this note being listed as a liability.

Preliminary audit indicates that this is not a bookkeeping error and that the businessman is intentionally trying to hide the loan. An investigation is now underway to determine whether the pension plan, which is otherwise suspected of at least questionable practices, made this loan as part of an effort to take over or criminally influence an established legitimate business.

#### **D. Implementation of Methodology**

One time-consuming problem, which would not have to be duplicated by law enforcement officials, was establishing a working relationship with a commercial credit agency. The establishment of mutual trust and confidence is important, as detailed information about a business may be wanted that is not on the published credit reports.

Identification of the unsecured loans in the pension plan portfolio was made in the analysis of pension plan fraud. Once a working relationship was established with officials of the commercial credit bureau, only five man-days of effort were required to determine that there may be an illicit relationship between the businessman and interests which affect the pension plan.

#### **E. Monitoring and Self-evaluation**

The examination of the unsecured loans made by labor unions and welfare and pension plans to businesses and businessmen may disclose general trends of organized criminal infiltration of business. If all loans were made to one type of business, this might indicate a concerted effort to dominate one industry. Appropriate investigative and enforcement actions could then be taken.

Careful attention should be given to the

form of business takeover attempted. If, for example, certain retail and wholesale operations were being taken over so as to take advantage of their established credit ratings, this would suggest certain enforcement actions as this form of criminal takeover is generally short-term. The takeover of other businesses may have longer-term implications, suggesting different enforcement actions.

Remedial action planning must focus upon removing the businessman from criminal-controlled financing. Where money is needed to pay legitimately incurred debts, even for bad business decisions, legislative attempts should be made to encourage legitimate lenders to make these relatively risky loans. This may be more cost effective than law enforcement efforts.

Patterns of lenders should also be analyzed. Particular attention should be given to how lenders learn that a businessman is willing to take such a loan. Of particular interest is determining whether the lender participated in a scheme to place the businessman in debt, such as by supporting gambling activities.

Self-evaluation and monitoring, here, may require considerable subjective analysis in terms of overall trends of business takeover, as opportunities to compare a lender's assets with a debtor's listed liabilities are limited.

## IV. CASE STUDY: SALE AND DISTRIBUTION OF UNTAXED CIGARETTES

### A. Hypothesis and Methodological Guidelines

The differentials among states in cigarette taxes are great enough to encourage the organized sale and distribution of untaxed cigarettes. For example, North Carolina taxes cigarettes at 2¢ per pack and Connecticut taxes cigarettes at 16¢ per pack, resulting in a total cost difference per pack of 14¢. If this tax can be avoided by first bringing cigarettes into the high-tax states from low-tax states, and, second, distributing them without paying the high state taxes, significant profits from seemingly legitimate operations can be obtained. In a high-tax state, legitimately sold cigarettes may be sold for 50¢ per pack with a gross profit of 5¢ per pack. Untaxed cigarettes, however, may be sold for 45¢ per pack with a profit of 15¢ per pack as the tax has not been paid. The buyer of the cigarettes, naturally, will buy the lower cost cigarettes.

If cigarettes are systematically brought into high-tax states for distribution, there has to be a distribution network. The bar owner or gas station owner who brings in a case of cigarettes every two weeks to sell to his friends or the out-of-town houseguest who brings his host several cartons of cigarettes are not considered to be part of organized criminal efforts to distribute untaxed cigarettes. One further assumption is that mass distribution of untaxed cigarettes takes place through seemingly legitimate distribution channels, e.g., existing wholesalers and retailers, before cigarettes are sold over the counter or through machines to buyers who are getting a bargain.

In most states, there are relatively few cigarette wholesalers who buy from the manufacturers. In a typical industrial state, eight to ten wholesalers distribute 90 percent of the cigarettes. Cigarette manufacturers send the following information to state tax authorities: statements of all cigarette orders and cancellations received from wholesalers in the state and the quantity of cigarettes shipped to the state. By

monitoring orders, sales, and shipments of specific wholesalers, deviations suggesting changes in the sale of untaxed cigarettes can be examined.

For example, if a wholesaler who regularly has ordered 1,000 cases of cigarettes per month for the last three months of each year decreased his orders to 300 cases per month in the last three months of the past year, a number of preliminary conclusions might be drawn. The wholesaler in question may be distributing untaxed cigarettes, cigarettes he did not order from the manufacturers, or his retailers may be obtaining bootlegged cigarettes or have shifted to another wholesaler. He also may be drawing upon an inventory built up in the previous months.

Rapid increases in recorded shipments from manufacturers to wholesalers may indicate that the distribution of untaxed cigarettes is decreasing, and that only taxed cigarettes are being sold.

Certain other relationships can also be established. Cancellation of orders already placed may, for example, follow a hijacking of a truckload of cigarettes. This may mean that the wholesaler who cancelled his order is going to distribute the hijacked cigarettes.

Since state tax authorities typically have investigative powers and can make unannounced audits, they should be able to determine the reasons for rapid increases or decreases in orders.

Identifying attempts to distribute untaxed cigarettes may lead to other forms of organized crime. Cigarette wholesalers often wholesale other high-value, low-weight merchandise such as razor blades and cosmetics. If a wholesaler is emotionally and logistically equipped to distribute illegally received cigarettes, he may also distribute other illegally obtained goods. These goods could come from hijacking during transit, theft from warehouses, or diversion of inventories preceding fraudulent bankruptcies.

The suggested methodology provides positive information on the orders and cancellations of cigarette wholesalers and cigarette shipments into the state. This information makes it possible to direct with some precision audit, investigative, and surveillance activities. Also, as factual information is provided, this information can provide the basis for grand jury examinations.

These methods are primarily useful in directing investigations and in monitoring the pattern of criminal activity during and after the investigation.

## **B. Summary Procedures**

1. Identify the cigarette wholesalers who account for 80 to 90 percent of cigarettes distributed.
2. Obtain historical records of orders and cancellations for these wholesalers from manufacturers.
3. Plot orders and cancellations for wholesalers by the month.
4. Plot sales for wholesalers by the month.
5. Identify the decreases in orders and cancellations that are due to legitimate reasons such as a decline in sales due to a new tax or increased competition.
6. Identify recent decreases in orders or cancellations that are not accompanied by decreases in sales or inventory, or that coincide with such circumstances as a hijacking in a neighboring state.
7. For recent and current decreases in orders and cancellations which cannot be explained by legitimate events, allocate police, investigative, and audit personnel.
8. Examine other activities of wholesalers, such as distribution of razor blades.
9. Implement a monitoring system to identify renewed attempts of the sale of untaxed cigarettes.

The next section describes the application of testing of these steps in a local law enforcement effort. The sections that follow it identify the resources required to implement and maintain a methodology to identify the sale of untaxed cigarettes and describe guidelines for monitoring and self-evaluation.

## **C. Analysis of Indicators of Sale of Untaxed Cigarettes**

The above assumptions and hypotheses were discussed in some detail with officials from the Cigarette Tax Division, Michigan Department of the Treasury. Analyses of this form were already underway, but interest was expressed in an approach for an overall monitoring.

All information pertaining to taxes is protected in Michigan; only certain public officials under specified conditions can review information pertinent to individual or corporate taxes. The information on cigarette orders and cancellations of individual wholesalers sent to state tax authorities is so protected. Inasmuch as project personnel could not review or analyze tax data, state tax officials conducted a test monitoring of orders and cancellations of a number of wholesalers.

At this time, one wholesaler has been found with unexplained declines in cigarette orders at a time when it appears that he is distributing as many cigarettes as before. Audits and investigations are now being conducted.

## **D. Implementation of Methodology**

The exact steps of the methodology cannot be outlined in any detail, as State tax authorities rather than project staff conducted the analysis. The entire analysis probably took between ten and fifteen man-days.

The restrictions on dissemination of tax data suggest that in most jurisdictions, the monitoring system should be established by officials of State tax authorities. Once a monitoring system is established, the initial data analysis should require only one to two man-days per month of a research analyst to identify trends of orders, cancellations, and shipments.

## **E. Monitoring and Self-evaluation**

A system that monitors wholesalers' orders and cancellations of cigarettes probably can identify with reasonable accuracy, over the long term, the large-scale distribution of untaxed cigarettes.

The above techniques focus only upon shifts in wholesalers' orders and cancellations of cigarettes. Since cigarette wholesalers often distribute either high-value items, such as razor



blades and cosmetics, changes in availability of these items through illegal networks should be examined. If organized thefts and hijackings of other items decrease as pressure is placed upon the distribution network of untaxed cigarettes, then perhaps even a larger part of the distribution network for illegally obtained goods is being eliminated.

Self-evaluation and monitoring, finally, should examine the per capita taxed cigarette consumption in the state. An overall index of the sale of untaxed cigarettes can be obtained by comparing a state's per capita cigarette consumption with other states. If the per capita

consumption of State A is rising, perhaps approaching the per capita consumption of State B, after tax authorities in State A have launched an effort to stop the sale of untaxed cigarettes, then one conclusion could be that smokers in State A have stopped buying untaxed cigarettes and are now buying taxed cigarettes. (In making these comparisons, other variables have to be accounted for such as age of population, tax differentials, per capita income, etc. The effect of these variables can be quickly understood by plotting per capita consumption figures over time.)

## V. CASE STUDY: ILLEGAL OFF-TRACK BETTING

### A. Hypothesis and Methodological Guidelines

Illegal off-track horse race bettors who place their bets with a bookie generally require information which is not printed in the daily newspapers. Information on past performances of horses and jockeys, on various tracks, under various weather conditions, and "expert opinions" is usually obtained through specialized racing publications sold by newsstands and drugstores rather than delivered directly to the reader. The fact that habitual bettors generally buy specialized racing publications forms the basis for this hypothesis: Fluctuations in the sales of racing publications sold by newsstands indicate changes in the level of illegal gambling. A rapid decrease in sales would indicate a decline in gambling due to either the unavailability of races to bet upon (a seasonal variation) or the unavailability of bookies to take bets (a variation due, primarily, to the effectiveness of law enforcement efforts) or both. A rapid increase in sales would indicate just the opposite—an increase in gambling due to the availability of races to bet upon or bookies or both.

If fluctuations in the sale of racing publications reveal the level and scope of gambling, then a systematic monitoring of these sales could assist law enforcement officials in a number of ways. Questions concerning the effectiveness of various law enforcement programs with respect to curtailing sports betting could be determined (e.g., should raids be made on anything but wire rooms? What have been the relative effects of specific raids by different law enforcement agencies, state and Federal?). Fluctuations in sales of racing publications are not the only source of information from newsstands selling them. It should be remembered that, if the hypothesis is correct, most publication sales, particularly covering out-of-state races, will be followed by a crime, the placing of a bet. For this reason, some indication of the gamblers' characteristics and identity would also be provided if newsstands with relatively high sales

of racing publications were watched. Finally, sales fluctuations could also be used to evaluate information obtained from informants and undercover investigators about changes in organization or direction by criminal organizations.

The procedure for carrying out an analysis of sales fluctuations of racing publications is straightforward. First, obtain records of daily or weekly sales of a popular racing publication at specific individual newsstands, covering a period of four or five years, eliminating those newsstands near racetracks or downtown bus stops for buses to the local tracks. After sales are plotted, identify events which occurred during the period and which may have affected sales of these publications. Some of these events are seasonal and quite natural, such as the opening and closing of tracks, weather conditions, importance of race, local economy, etc. However, some of these events are not natural. These events, which are of particular interest to law enforcement officials, are the opening and closing of bookie operations, changing of "lay-off" points, and changing willingness or capabilities of bookies to take bets. The third step in the procedure, after events have been identified which may have affected sales of racing publications will be to determine the relationships between the occurrence of these events and sales fluctuations.

One group of "events" which will need to be examined closely will be past police raids on bookie operations, wire rooms, and lay-off points. Past raids are of particular interest because they reflect the most common police response to gambling, they are presumed to deter illegal sports betting, and they require considerable manpower. Some attempt should be made to classify these raids in terms of type of operation raided, information upon which the raid was based, and law enforcement agencies which participated.

As relationships between past events and sales fluctuation are determined, it may be possible to draw inferences for use in an ongoing monitoring of racing publication sales. Inferences,

which would be different for each locality, might include:

1. Gambling does not decrease significantly unless the lay-off point is closed down.
2. The bookies who take bets on horse races also handle all sports betting.

As understanding of the incidence and scope of gambling is obtained through a continued analysis of the fluctuations of racing publications, conventional law enforcement investigative techniques can be focused and used efficiently. There are other related investigative benefits from focusing on racing publication sales. Frequent purchasers can be identified and placed under surveillance. Telephone numbers dialed by habitual purchasers of racing publications can be obtained by subpoena from telephone companies and examined to identify possible bookies' telephone numbers. For purchasers not in the habit of calling in bets, their places of work may be identified through surveillance, and their bookies identified in the same way. In general, then, the monitoring of the sales of racing publications may provide the following:

1. Changes in the scope and incidence of gambling.
2. Effectiveness of past law enforcement actions in reducing gambling.
3. Increased understanding of the possible effectiveness of planned future actions.
4. Criteria for better evaluating the effectiveness of actions taken to reduce betting.
5. Better information about the characteristics of sports bettors.
6. New investigative leads with respect to both the gamblers and bookie.

The procedures discussed above are primarily aids for directing the focus of any actions following the investigation.

## B. Summary Procedures

Listed below are the methodological steps described above in context with the way in which part of illegal off-track betting takes place.

1. Determine which national and local racing publications are sold regularly in an

area, especially where these cover out-of-state tracks.

2. Identify locations where these publications are sold, particularly in central business districts and industrial complexes.
3. Obtain, preferably on a daily basis, records of sales of the important publications for the past four to five years.
4. Plot the sales data and identify unusual perturbations.
5. Identify events which may have caused these perturbations, particularly past law enforcement actions such as raids or known changes within the gambling community.
6. Identify the degree to which past events seemed to have inhibited or decreased the level of gambling.
7. Utilize continuing sales data collection to evaluate future enforcement initiatives.
8. As possible, avoid actions in the future which did not appear to inhibit gambling.
9. Identify information to be collected from newsstand surveillance by conventional intelligence techniques if racing publication sales do not decrease or increase. Information might include: names and business of suspected gamblers, telephone numbers they call, and relative concentration of suspected gambling in a city.

The next section describes the application and testing of these steps in a single city, separate from any law enforcement effort. The analysis was carried only to the point where it was proven that certain police raids in the past correlated with increases and decreases in the sales of racing publications. The application of the steps described above must be modified for different cities, taking into account availability of local tracks, general attitude toward gambling, and availability of reliable and confidential circulation data for racing publications.

The sections following the case study identify the resources required to implement and maintain a methodology to identify changes in the scope and incidence of gambling and describe guidelines for monitoring and self-evaluation.

### C. Analysis of Indicators of Illegal Off-track Betting

An investigation of illegal off-track betting, utilizing the techniques described in the summary procedures, was undertaken in Detroit, Michigan. This analysis was not part of a law enforcement effort; however, a number of enforcement officials did participate informally by commenting upon the analysis and providing information on past police raids.

The sales of a single, nationally distributed racing publication were obtained for a three-year period for a number of downtown newsstand and drugstores. Exhibits 3, 4, and 5\* display the weekly sales distributions for each of the three years for which data was obtained.

At the time of this analysis, the major issue in question was the relationships between police raids upon betting parlors (generally locations

\*In order to protect sources and avoid inhibiting possible future investigations, the actual years are not identified. Also, the magnitude of sales is given only on a relative scale.

where bettors could place bets in person) and wire rooms locations where bets were taken and results reported by telephone). It was assumed that these raids were made with the ultimate objective of reducing or inhibiting gambling and, if effective, would affect the sales of racing publications for at least a short period of time. The dates of all past raids were obtained from cooperating law enforcement officials.

The general shape of the annual curve, from a low between Christmas and New Year, to a mid-season high in early summer (the so-called "bell-shaped curve"), coincides with the number of tracks open and appears to show a correlation between racing activity and the distribution of off-track betting over the year.

In the first quarter of Year 1, sales declined rapidly following a raid. Sales rose in the second quarter, when there was a slight decline which could not be attributed to any known change in gambling activity, and peaked in the second week of June. This was followed by a steady

EXHIBIT 3.—Sales Distributions at Selected Newsstands For Year 1

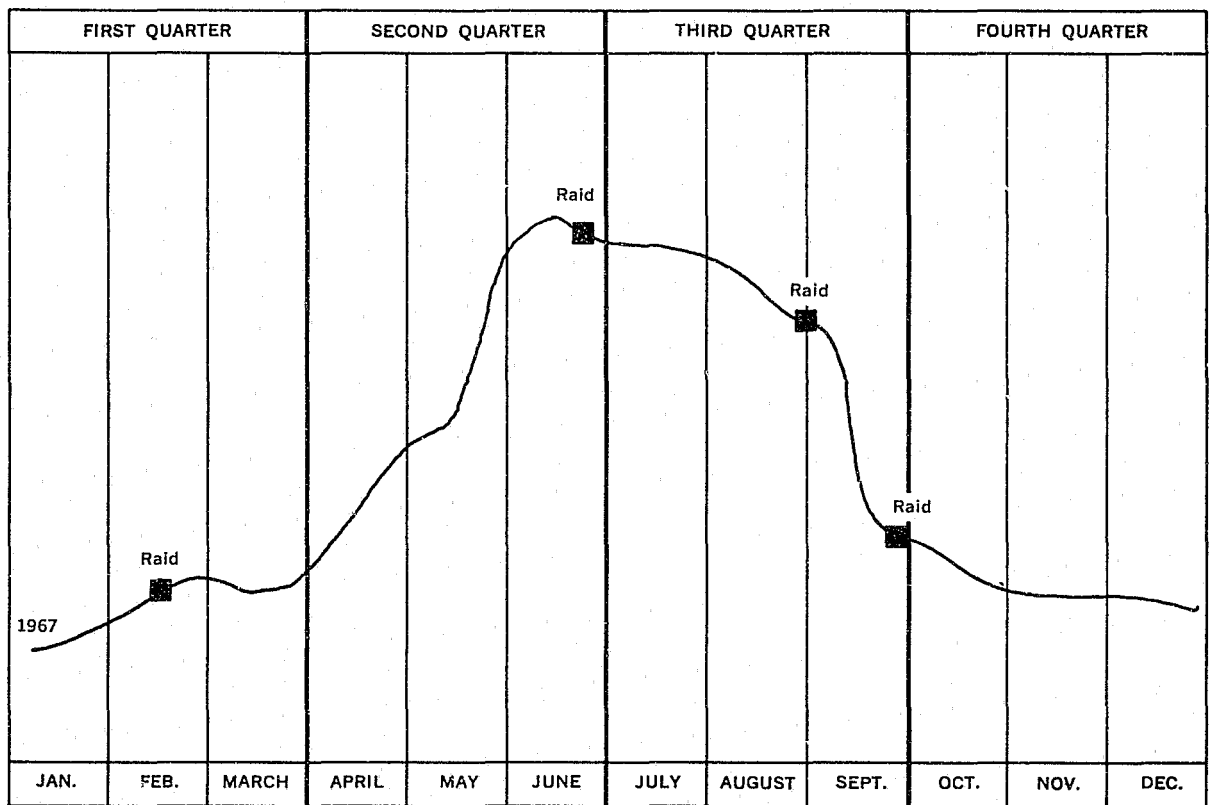
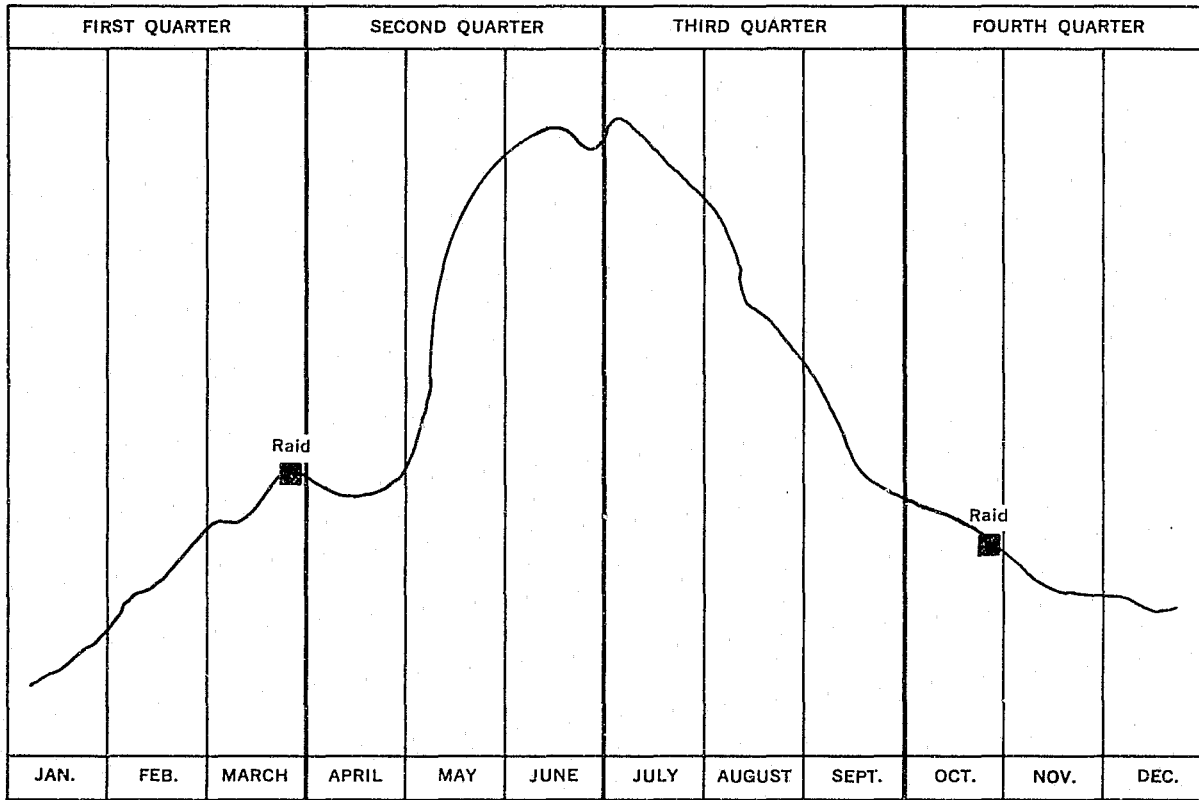


EXHIBIT 4.—Sales Distributions at Selected Newsstands For Year 2



decline into the third quarter. During this second quarter, one raid was reported. This raid was not followed by an accelerated decrease in publication sales; in fact, immediately after the raid the rate of decline decreased.

The third quarter showed a steady decrease in sales until the first week of September, followed by a rapid decline in the next two weeks' sales. This sales decline was halted after the second week of September, and sales stabilized as they entered the fourth quarter.

Two raids took place in the third quarter of Year 1. The first raid was followed by a rapid two-week sales decline, which then stabilized. The second raid was followed by a slight decline in sales in the fourth quarter.

The fourth quarter began with an increase in the sales decline following the second raid. Sales stabilized in November and remained steady through the rest of the year.

In Year 2, sales distribution follows the same shape as Year 1. There was a steady increase in sales until the first week of March, when sales

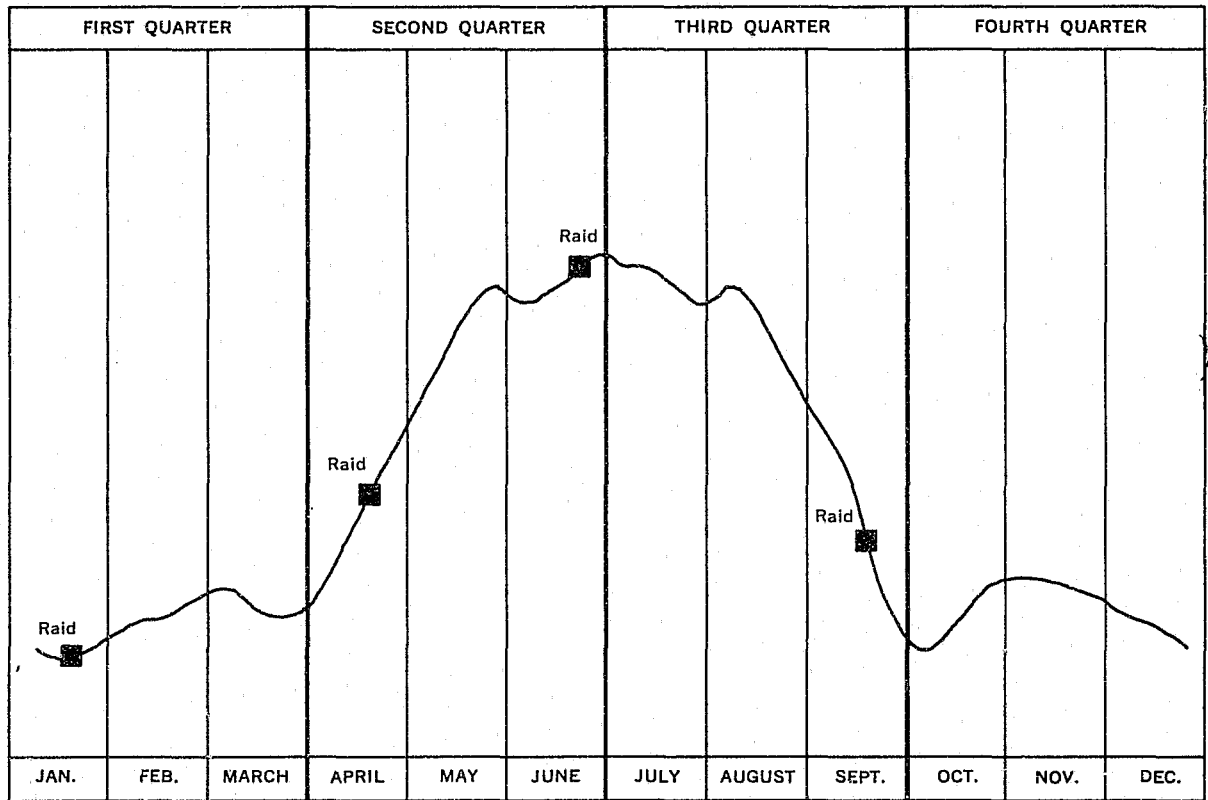
stabilized for two weeks. Sales then rose rapidly for two weeks and peaked in the last week of March.

At the beginning of the second quarter, sales fell rapidly until the third week of April, and then rose rapidly until the third week of June. Sales then declined for the balance of the quarter. The rapid decline in second quarter sales in April immediately followed a raid. The decline in sales beginning the second week in June was not preceded by a known raid.

Sales in the third quarter rose rapidly for the first two weeks, and then began a steady decline. This decline stabilized for two weeks at the third week in August, and then continued into the fourth quarter. The two perturbations in the third quarter occurring at the first week of July and third week in August neither preceded nor followed any known raids.

The fourth quarter sales showed a steady decline. While there was a raid late in October, there is no noticeable perturbation in the established sales decline.

EXHIBIT 5.—Sales Distribution at Selected Newsstands For Year 3



In Year 2, then, there were two known raids. The March raid was followed by a sales decline while there was no noticeable change in sales decline after the October raid.

While it is possible to draw some inferences from each of the two sales distributions concerning the effect of raids upon the sales of racing publications, other inferences, perhaps more useful, can be drawn by comparing the sales distributions for Year 1 and Year 2.

Exhibit 6 displays the sales distributions of Year 1 and Year 2. These two curves indicate that the sale of racing publications is consistently higher in Year 2 than in Year 1, suggesting increased gambling activity.

Looking at just Year 1 and Year 2 data and, again, assuming that changes in sales volume are related to the effectiveness of raids, the following inferences can be made:

1. The Year 1 February raid was relatively effective, as first quarter Year 1 sales remained substantially lower than first quarter Year 2 sales.

2. The Year 1 February raid was more effective than the Year 2 March raid, as second quarter Year 1 sales were lower than second quarter Year 2 sales.

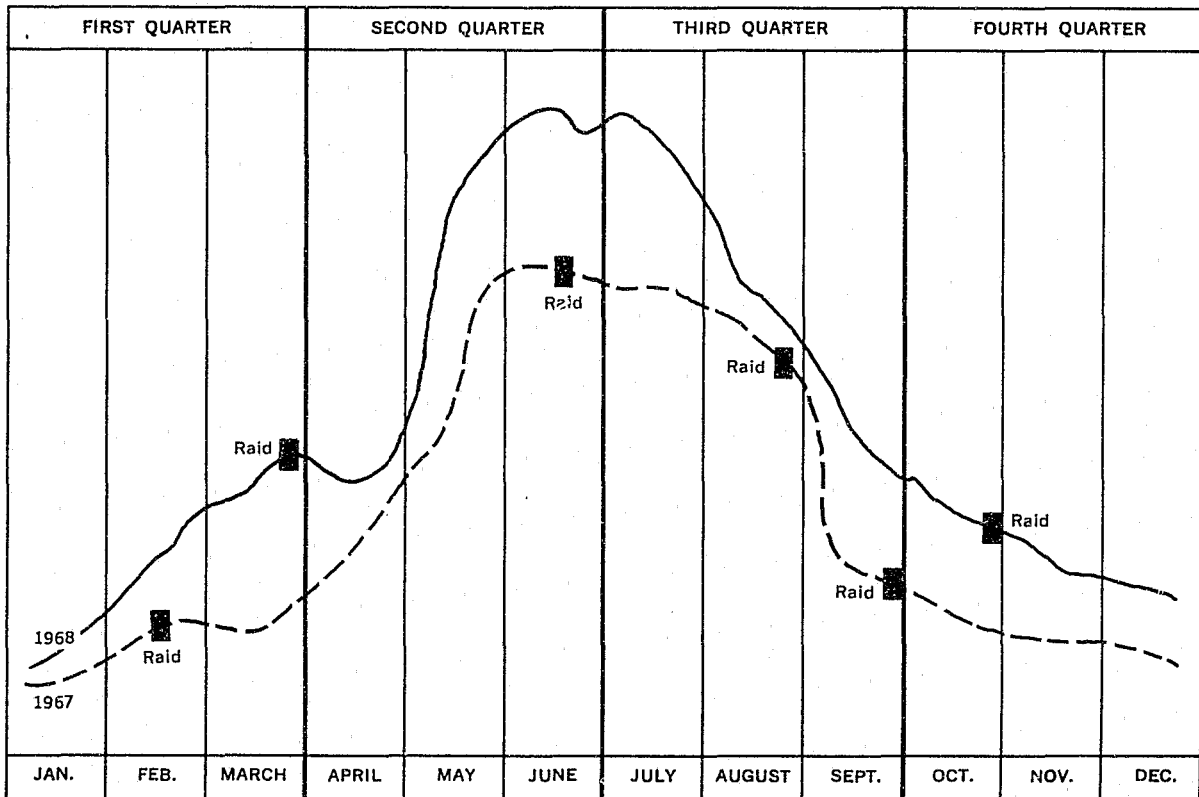
3. The lower fourth quarter Year 1 sales may be attributed to the Year 1 September raid and the absence of effective raids in the fourth quarter of Year 2.

These fluctuations suggest strongly that the effectiveness of various raids have been measured.

There were similar relationships in Year 3 between raids and sales fluctuations. A comparison of sales for all three years, as seen in Exhibit 7 further suggests that the effectiveness of raids over a period of three years has been measured.

The analysis also considered the possibility that observed sharp fluctuations beyond the shape of a bell-shaped curve might also be traced to other events such as the opening and closing of popular tracks, weather conditions at the tracks, important claiming races, big stake

EXHIBIT 6.—Sales Distributions  
For Years 1 and 2



racers, betting volume at the tracks, and so on. Data on the opening and closing of tracks and the volume of betting at these tracks (the daily "handle") was obtained and reviewed, but it did not suggest any interpretations other than those arising out of the analysis of sales and raids.

Although the results of this analysis were reviewed with interest by a number of state and local law enforcement officials, there have been no attempts to test the utility of information dealing with fluctuations in racing publications sales as an ongoing measurement of current investigative effectiveness.

#### D. Implementation of Methodology

The test program had difficulty with one problem that law enforcement officials should be able to resolve early: obtaining the circulation data.

Considerable time was required to obtain the weekly sales of racing publications. Publishers and distributors were reluctant to provide

these figures. They asserted that there was no relationship between specialized racing publications and illegal off-track betting. The problem of obtaining sales figures would probably be reduced considerably if inquiries were made directly by law enforcement officials.

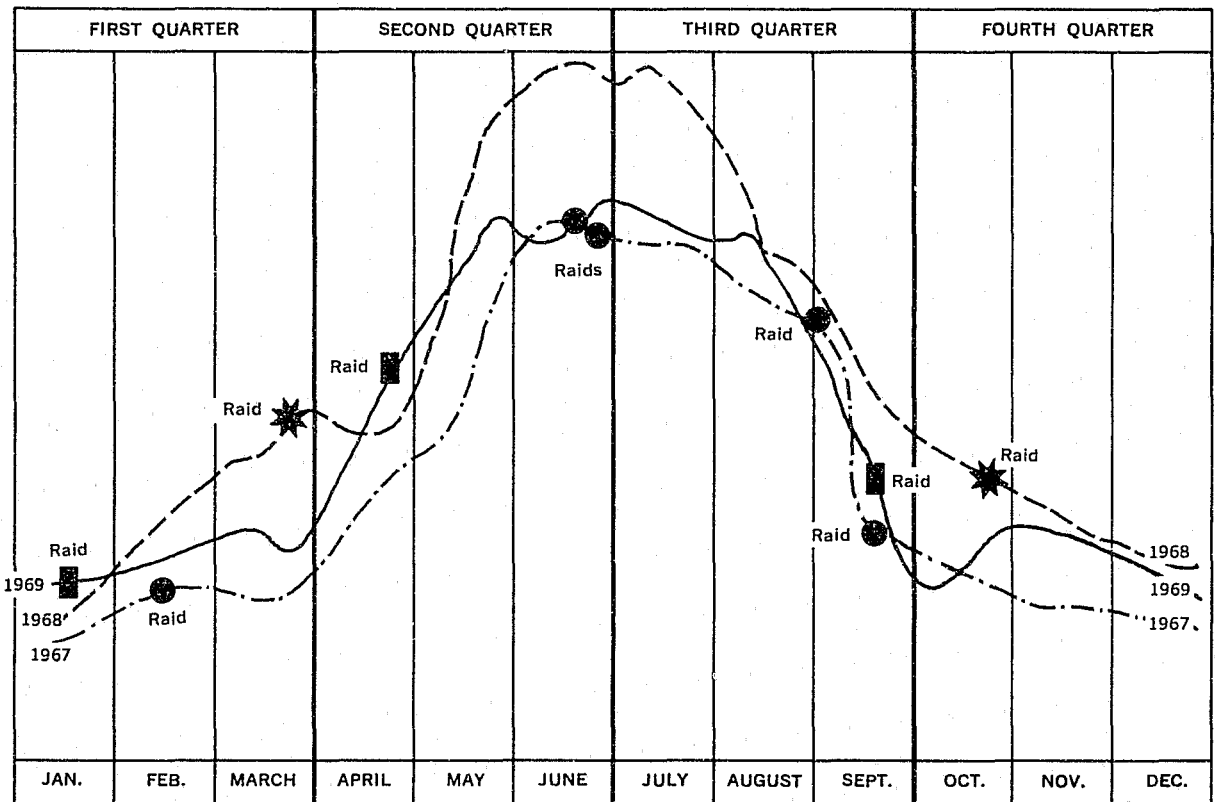
Obtaining the circulation data and plotting it required twelve man-days of project personnel. Comparing the sales distributions with dates of raids required three man-days of project personnel.

If sales data was regularly monitored by police investigators, the information gained both from sales totals and individual sales of racing publications might be useful in guiding investigations, placing surveillance on certain individuals, developing informants, placing undercover agents, and obtaining warrants.

In summary, an estimate of the time and personnel required to set up and monitor the daily sales of racing publications for 25 newsstands is:

| <i>Project</i>   | <i>Manpower Requirements</i>   |
|--|--|
| Step 1: Obtain historical circulation data, and arrange for provision of current data.   | 1-5 days of policy-level enforcement official.                             |
| Step 2: Plot historical data and note fluctuations.  | 3-5 days trained clerk.  |
| Step 3: Obtain data on events which may be related to fluctuations (e.g., weather, raids, important races).                    | 1-5 days policy-level enforcement official;<br>1-10 days of trained clerk. |
| Step 4: Identify relationships among sales fluctuations and events.  | 1-5 days enforcement official;<br>1-10 days trained clerk.                 |
| Step 5: Identify those fluctuations which, locally, identify changes in gambling.  | 1-5 days enforcement official;<br>1-3 days trained clerk.                  |
| Step 6: Identify appropriate investigative procedures to follow or precede future fluctuations (e.g., surveillance, subpoena). | 1-7 days enforcement official;<br>1-5 days trained clerk.                  |
| Step 7: Monitor sales fluctuations.  | $\frac{1}{2}$ day trained clerk per week.                                  |

EXHIBIT 7.—Sales Distribution For  
Years 1, 2 and 3



The analysis of sales data is quite simple. The results of the analyses might most appropriately be submitted to existing intelligence operations for review in context with all other investigations. Such a monitoring system could probably be established with ten man-days of policy-level enforcement personnel and twenty man-days of a trained clerk. The monitoring would require less than one-half day per week of a clerk.

### E. Monitoring and Self-evaluation

This approach to the identification of patterns of illegal off-track betting serves to reduce considerably the manpower requirements that are normally required to identify gambling. Once localized patterns are identified, it becomes possible to develop factual information about gamblers and the people they associate with both in person and by telephone. Further, it may be possible to obtain the telephone num-



bers suspected gamblers are calling. Finally, changes in the patterns of gambling can be noted after law enforcement action is taken. Although new and factual information can be obtained through the monitoring of racing publication sales, it would be wrong to believe that this technique can be rigidly applied as it would be easy for gambling interests to disrupt sales patterns; e.g., by threatening newsstand dealers or making bulk purchases. As such perturbations appear, a few days of surveillance would probably be sufficient to determine the cause of the change.

It is probable that patterns of gambling, as they exist today and in the recent past, could be identified which would lead to the established relationship between gamblers and their bookies. As factual information is obtained, the pressure upon gamblers and their bookies would perhaps be increased. Eventually these pressures should result in either a reduction in loan sharking or a change in the method by which bets are placed. If suspected gamblers stop buying racing publications and calling their bookies, it should be relatively easy to determine where gambling information is com-

ing from and how bets are made. These surveillances might also identify quickly relationships between illegal horse betting and other forms of gambling, particularly sports betting.

The above monitoring and self-evaluation techniques are based upon an identification of the relationships between fluctuations in the sale of racing publications and possible gamblers and their bookies. It may be worthwhile to identify and monitor other phenomena, such as employee possession of racing publications in offices or plants and unusual telephone calls being placed by employees one-half to one hour before races are run. In some cases, there may be relationships between productivity, loss of tools and valuable materials, and gambling. A rise in productivity may mean that, at minimum, less employee time is spent making bets. A rise in tool losses may mean that tools are being stolen to pay gambling debts.

Some of this monitoring and self-evaluation may be conducted as a cooperative effort with businessmen and labor leaders. This dual function, then, might be built into certain business procedures, and any suspicious trends or aberrations reported to law enforcement officials.

## VI. CASE STUDY: BUSINESS EXTORTION

### A. Hypothesis and Methodological Guidelines

A common form of business extortion is for a supplier to force a businessman to buy his goods or services by threatening him or his property or by threatening to withdraw needed goods or services.

In either case, the businessman is placed in a position of great risk if he does not satisfy the extorter. The extorter is able to make his threats valid as he represents a criminally infiltrated business. He has the necessary influence and power physically to harm individuals and property and withhold needed goods and services; furthermore, the businessman being extorted knows this.

Another form of extortion is where the businessman himself is not extorted, but otherwise unavailable illegal services are offered which the businessman wants, such as a short-term loan or assistance in reducing labor problems.

Organized criminal involvement in the coin-operated machine industry is a common assertion, and has been identified a number of times. The coin-operated machine industry has been a desirable target for organized crime for many reasons. First, as a legitimate business it is profitable, and the profitability is further guaranteed when the customers of the machines are extorted. Second, coin-operated machine businesses are high-cash-volume businesses which provide an effective cover for the movement or temporary holding of cash gained from illegal activities. Third, the merchandise, food, and cigarette machine industries provide a means for the distribution of illegally obtained goods. Fourth, the "nonproduct" machines, amusement devices and jukeboxes, produce nondocumented incomes which can be falsified so as to allow the "laundering" of monies obtained from illegal activities. Fifth, the servicing of machines provides entrée, on a regular, frequent basis into business establishments. The job of vending machine serviceman provides exceptionally good cover for the gambler, numbers runner, loan shark, or narcotics dealer whose presence to service the machine on a fre-

quent basis is not only unquestioned, but is rather encouraged by the proprietor of the establishment in which the machine is placed. Furthermore, the routeman routinely carries business forms and cash, and additional business forms and monies representing other activities could therefore be easily hidden.

The size and profitability of a coin-operated machine business depends both on the quality and quantity of locations serviced by a company. At each location one or several machines, depending on the type of machine, are placed. The competition which occurs among the coin-operated machine businesses is a competition for locations. Machines are placed within business establishments, whether it be a bar or a large factory, and the coin machine businesses compete for these locations. Legitimate competitive practices include the offering of a more profitable division of machine income, a newer, higher-quality machine, a greater variety of machines or more frequent service to the proprietor of the location where the machine will be placed.

Illegitimate competitive practices are those of direct business extortion or the willingness to provide illegal services. One form of extortion may take the form of threats to do injury to the person or property of the owner or manager of the location. Extortion may also be in the form of guarantees ranging from promises that labor problems will be avoided to the provision of loans, perhaps at usurious rates of interest. Gaining of locations through the provision of services would include the offer of a loan to redecorate a bar to an individual who could not qualify for a legitimate loan. The loan is at usurious rates, and the coin machines are placed to aid in the guarantee of repayment, as the extorter himself removes money from the machines.

Regardless of the type of threat or service involved, illegal competitive practices by the extorter result in his acquisition of machine locations and, consequently, the number of actual machines operated by the extorter in-

creases. Furthermore, since the extorter relies upon nonmarket forces to gain clients, his holdings are not likely to decline when the industry as a whole suffers a setback. The extorter's operation is not subject to normal market behavior, but rather deviates from normal expected behavior.

A specific result of extortion is that the business profiting from extortion will show unusual patterns of growth, likely in one of the following ways. On the one hand, its size will increase without regard to its competitive position or at an atypical rate in relation to the other machine operators. This may manifest itself in a sudden, large expansion in the number of machines operated by an ongoing business or in the unexplained appearance of a new business which, in its first year of operation, services a large number of locations. On the other hand, when the industry is highly competitive and locations typically change hands, the extorter is likely to show a marked stability in his holdings. A general result of extortion is that, in the aggregate, the growth patterns within the industry do not match the expected competitive positions, given the sizes and types of firms operating within the industry.

Accordingly, the analysis necessary to identify extortionists has two parts. The first focuses upon the determination of the atypical coin machine firm, the one benefitting from extortion practices. The second focuses upon the aggregate industry patterns and can be used to determine the general health of the industry vis-a-vis the level of illegal activity.

The general procedures will be described in the next several pages, and the steps more specifically stated in the *SUMMARY PROCEDURES* which then follows. The case study should be read both as a demonstration of utility and as a detailed explication of how the analysis is accomplished. In general, a computer program has been developed which accomplishes the entire analysis with great rapidity and at low cost and produces easily interpreted results.

#### *Identification of the Extorter*

Because extortion manifests itself in a pattern of atypical market performance by the benefiting firm, the extorter can be identified by studying both the number and location of all machines operated by all firms in minimally

two consecutive years. Furthermore, the analysis must be conducted by industry sector. Jukebox distributors compete with jukebox distributors and amusement device distributors with amusement device distributors; jukebox distributors do not compete with amusement device distributors. Although one firm may handle more than one type of machine, the sectors must be looked at as independent entities, as the markets, clientele, and legitimate competitive practices differ.

The analysis described is directed at the identification of, first, businesses guilty of business extortion or the offering of illegal service; second, businesses which suffer a loss of clients as a result of the illegal practices of their competition; and third, the extorter's client, the individual forced to take the machines because of extortion. The identification of the business extorter and the company losing business because of extortion requires data specifying the number and type of machines operated by each company in minimally two recent, consecutive years.

The identification of the individual extorter requires data specifying the location of each machine operated by each business in the same years. The data required is generally available in the following places. Data on amusement device, jukebox, and merchandise vending machine holdings is available at the licensing bureau in all cities where coin-operated machine owners are required to take out a single license for each machine owned. Data on food vending machines is usually available either at the city licensing office or at the local department of health under whose jurisdiction the food vending machines may have been placed. Data on cigarette vending machines is again available either at the city licensing office or at the State Treasurer's office as often cigarette vendors must register their machines with the State due to State tax regulations. Furthermore, a city's property tax or assessor's office will likely have data showing the holdings of all coin machine operators. This data is likely to be the most complete, as they specify not only the number of machines by type held by each operator, but also the location at which each machine has been installed. Tax data is also valuable as it indicates the assessed value of each machine owned. Whereas general licensing in-

formation is usually considered to be only "administratively confidential" and can be readily obtained, the information at the tax assessor's or property tax office may not be. The availability there will depend upon whether or not the data was submitted as a part of the tax return or collected by the assessor's office independently in order to verify tax returns.

To determine typical rates of growth or stability, the firms operating must be categorized by size of operation since there are different market forces affecting and different competitive positions associated with each type of operation. The categories used are based upon the number of machines operated by each particular business. The categories are:

- Category 1: Operators with 1-3 machines.
- Category 2: Operators with 4-9 machines.
- Category 3: Operators with 10-29 machines.
- Category 4: Operators with 30-99 machines.
- Category 5: Operators with 100 or more machines.

The Category 1-3 machines is comprised of a single restaurant, bar, or cafeteria owner who owns and installs his own machines at one or two of his own locations. The stability of his holdings is thought to depend upon the health of his primary business. If the business is successful, it is unlikely that the operator will sell or otherwise give up his machines, having made the investment, unless he can no longer adequately service them himself. On no account, however, are his holdings likely to expand beyond the level needed to service his own establishments.

The Category 4-9 machines suggest businessmen who run small vending machine businesses, usually on a part-time basis to supplement their regular income. Of the vending machine businesses, this is the least competitive, as locations tend to be "poor."

The Category 10-29 machines represents businessmen who own small operations which are run as full-time businesses by the owner with only part-time or no employees. The firms in this category are generally aggressive competitors.

The Categories 30-99 and 100 and above both suggest large vending machine operators

with one or several full-time employees. These firms are the most aggressive and competitive and usually handle a full line of coin-operated machines. Because of their ability to provide full service to their clients, and their willingness to develop new clients by providing initial services free, such as machine installation and the first few weeks of operation at "no cost," they have a strong competitive advantage over smaller firms. In the analysis, however, the businesses with 100 machines and more are dealt with as a separate category; otherwise, the analysis would lose its sensitivity.

Identification of extortionists within each category of machine operations is based upon, again, identification of atypical growth rates. To identify atypical rates of growth for each category of machine operators, the average or mean rate of change in the size of machine holdings is computed, and the change registered by each firm is normalized in relation to the mean. The higher the normalized rate of growth, the greater its significance. In general and as a rule of thumb, whenever the change in holdings is greater than or equal to two times the average change, i.e., when the normalized rate of change is greater than or equal to + or -2, its growth pattern is to be considered unusual. Those with high positive rates of growth are thought to have gained from a heightened competitive position and perhaps to be engaging in practices of extortion. Those with high negative rates of growth have likely suffered from a reduced competitive position due to the practices of competitors. The first group, then, those with unusual rates of positive growth, are potential objects for investigation; the second group, those with unusual rates of loss, are potential sources of information regarding extortion practices.

Abnormal growth for ongoing operators was defined as atypically large increases in machine holdings from one year to the next. Extra-legal practices may manifest themselves in a second way and can be inferred when a business has unusually large holdings in its first year of operation. Initial holdings of more than ten machines are particularly unusual for several reasons. First, because of the capitalization required to purchase the machines; second, be-

cause on the average new operators are single individuals who service the machines on a part-time basis and not the owners of large companies with one or more full-time employees; and finally because the capturing of an additional ten locations in a single year is a difficult task for even a large, ongoing business. In larger cities, the addition of ten machines to a new firm generally means that locations have been switched from established firms to the new firm. Therefore, any firm which in its first year of operation has more than ten machines is suspected of extra-legal business practices.

The final category of unusual market performance is that of unusual stability. If, when the average rate of change is fairly high, and a high percentage of the machines were licensed by operators experiencing significant change, then any firm whose holdings remain constant is experiencing an unusual business pattern. This firm should also be considered suspect. This is particularly the case where the industry turnover is due to the introduction of advanced machine types, such as four-channel stereo equipment substituting for single-channel jukeboxes.

The second part of the analysis is directed at the identification of those locations where the proprietor has been victimized by the extortion practices. This analysis depends upon access to the information on machine locations. The most worthwhile identities for investigative purposes are those most recently victimized. To determine these, the location lists for the two most recent years are examined, and the names of the new clients are recorded. A search of all location information for the previous year is then made to determine if that location was serviced by another company in the previous year. Whenever a location is found to have been transferred from one operator to a suspect operator, the assumption of extortion as the reason for the transfer is suggested. Informal visits to these locations by investigators knowledgeable of the recent transfer might quickly reveal whether or not extortion has taken place.

### *Determination of the Level of Organized Criminal Activity*

The identification of firms potentially guilty of illegal business practices was accomplished by determining typical rates of growth for various types of firms and then by comparing the actual rates of growth of individual firms to the average rates of growth of all firms of the same type. The determination of the overall level of organized criminal influence upon the industry is accomplished by comparing overall market performance to the norm of expected performance as derived from general economic theory.

Generally, in a stable industry not affected by significant innovative or technological change and characterized by aggressive competition, small operators are more vulnerable to competition than large ones and large operators often obtain their gains at the expense of the small operators. The reason is that the larger the firm, the better its competitive position. If this is the case, in those areas where there is a large turnover of locations in the coin-operated machine business, the small operators should register a high percentage of losses and a low percentage of gains, while the medium and large operators should register fewer losses and higher rates of gain. Thus, losses should be low for the large operators and higher for the medium and small operators, and gains should be high for the large operators and lower for the medium and small operators. Further, when a high rate of machine location turnover is occurring in an extortion-free industry, it is indicative of intense competition. In such cases, the introduction of new firms with a large number of locations in their first year of operation would be highly unlikely. In sum, these are the expected characteristics of market performance. When significant deviations occur, when market performance runs contrary to that expected, the likely explanation is that the deviations are resultant of extortion practices which are subverting the normal market patterns.

The analysis of the coin-operated machine industry, sector by sector, is carried out by comparing actual industry performance to the set of assumptions just described. The analysis relies upon the same data base as used in the previous section: the specification of the number of machines owned by each operator in minimally two recent consecutive years. The

analysis will further utilize the categorization by tiers of operating businesses in accordance with the number of machines owned by each firm.

The analysis proceeds with the assumption that on the average, the market performance of a tier should generally be reflective of its control of the market. If, in a given year, 50 percent of all machines are operated by businesses owning 30-99 machines, then, as a point of departure, it is assumed that 50 percent of machine losses and 50 percent of machine gains will accrue to that tier. This, however, suggests that the distribution of machines and losses is random. It is not. It is affected by the competitive position of firms. It has been stated that competitive advantage increases as does the size of firms. Therefore, the above distribution prediction based upon share of market controlled should be modified. Rather than tiers accruing losses and gains equal to the percentage of the market controlled, the tiers made up of large firms should show rates of gain greater than the market share controlled, and rates of loss lower. The tiers comprised of smaller firms should register rates of gain less than their market share, and rates of loss higher. One further point needs to be made. Each year new businesses come into being. It would be highly provocative if a large percentage of new machines put into operation in any given year are operated by new businesses.

If the analysis shows that the rates of gains and losses accruing to the various market sectors is in contradiction to their competitive positions, then there is reason to believe that the free market forces are being abridged by extralegal activities. However, as extortion or illegal practices diminish, the normal market forces will prevail and a trend towards increased market control in the hands of the large, ongoing operators will be evident.

## B. Summary Procedures

### *General Procedures*

1. A specific industry sector is selected for analysis and for that sector the following data is collected:

- a. The number of units operated by each business in each year.
- b. The addresses of locations serviced by each business in each year.

2. Organize the data into categories according to the size of each business. The size is to be measured in terms of the number of units operated by each business. Appropriate categories for the coin-operated machine industry are:

- Operators with 1-3 machines.
- Operators with 4-9 machines.
- Operators with 10-29 machines.
- Operators with 30-99 machines.
- Operators with 100 or more machines.

### *Procedures for the Identification of the Extorter*

1. By category, determine the change in the number of machines operated by each business from one year to the next.

2. For each category, compute the average or mean number of machines gained or lost. This is calculated by summing the changes registered by each operator in each category and then dividing the sum by the total number of operators in that category.

3. To normalize the changes in terms of the average and thereby derive a measure suggestive of the significance of the growth or shrinkage experienced by each operator, the actual change of each firm is divided by the average change. Any result less than one is to be considered trivial. As the magnitude of the number increases, the importance of the change experienced is seen to grow. The final determination is subjective, but as a rule of thumb, any change greater than twice the average or expressed as a normalized change greater than or equal to two might be thought significant.

4. To determine the identity of those locations victimized by extortion, turn to the list of locations serviced by the suspicious firm in each of the two years. Determine which locations were "new" in the second year and determine if those locations were serviced by other operators in the previous year. When the location was found to have been taken over by the suspicious firm, there is reason to believe that extortion may have been the cause of the location change.

### *Procedures for Determination of the Level of Organized Criminal Activity*

1. For the industry sector being analyzed, compute the total number of machines in opera-

tion for minimally each of two consecutive years.

2. For each category of operators within the industry, sum the total number of machines in operation in each of the two years.

3. For each category of machine operators within the industry, compute the total number of machines gained by operators who increased their holdings from the first year to the second.

4. For each category of machine operators, compute the total number of machines lost by operators whose holdings decreased from the first year to the second.

5. Across all categories, sum the total number of machines gained by machine operators whose holdings increased from one year to the next.

6. Across all categories, sum the total number of machines lost by operators whose holdings decreased from one year to the next.

7. For each category, determine the total number of machines operated by any firms who were not in business in the previous year.

8. For each category, for each year, compute the total number of machines in that category as a percentage of the total number of machines in the industry. This is a measure of the percent of the industry controlled by operators of a particular size.

9. For each category, compute the gains accrued to operators from one year to the next as a percentage of the total number of gains.

10. For each category, compute the losses to operators from one year to the next as a percentage of the total number of losses.

11. Compute the total number of machines operated by "new operators" as a percentage of the total number of machines in operation.

12. Sum the total number of machines gained from one year to the next and the total number of machines operated by "new operators" the second year.

13. Compute the number of machines operated by new operators as a percentage of the total number of machines gained plus the number of machines operated by new operators.

14. For each category, compute the number of machines held by new operators as a percentage of the total number of machines operated within that category.

15. Compare percentage of market controlled with percentages of machines gained and lost within each sector. Compare sizes of firms to rates of gain and loss. Specifically, determine if the larger firms are accruing machines at proportionally greater rates than smaller firms. Study the percentages of machines accrued to new operators both as a percentage of the industry and as a percentage of gains. The industry is considered healthy to the degree to which:

- a. New machines to new operators appear insignificant.
- b. Losses accrue proportionally more heavily to small firms than large.
- c. Gains accrue proportionally more heavily to large firms than small.
- d. The market control of the large firms grows while that of the small diminishes.

#### C. Analysis of Extortion Practices in the Coin-Operated Machine Industry, Detroit, Michigan

This analytical procedure was developed and first applied in Detroit, Michigan. The data showing the number of machines held by each operator was obtained from the Detroit City Department of Licensing; the data showing the locations serviced was obtained from the Detroit City Tax Assessor's Office. The analysis conducted monitored licensing patterns of jukebox and coin amusement devices in Detroit for the years 1960-1970. The analysis was conducted by individuals with no knowledge of extortion practices in the area. The findings can be briefly summarized before the analytics are described. First, the analysis suggested that extortion practices were occurring as early as 1963; the law enforcement intelligence divisions operating within the city did not in fact learn of such activities until 1965-1966. The analysis provided a description of the manner in which the "extorters" were distributing new holdings among dummy firms, a procedure which was suspected by law enforcement intelligence divisions. The analysis yielded the names of seven operators with unusual growth patterns, five of which were verified by police intelligence as being suspected of extortion practices. The analysis further yielded a partial list

of fifteen locations which were suspected to have been extorted. The Wayne County Organized Crime Task Force is using this information to provide background information useful in questioning involved parties and to guide current and ongoing field investigations.

The analysis is presented here as it was actually carried out in Detroit. In the context of the Detroit study, the analysis of the market activity in general was conducted first and is described in the section entitled *Market Characteristics*; the identification of individuals guilty of and adversely affected by extortion practices was conducted second after the first section was completed and is described in the section entitled *Identification of Extorter*.

#### *Market Characteristics*

The overall size of the jukebox and amusement device industries of Detroit, Michigan, stabilized in 1963 after several years of rapid growth. The number of jukeboxes levelled off at approximately 1,750, with an annual mean percentage change in the total number of machines licensed since then of  $\pm 3.5$  percent, amusement devices approximately at 2,550, with an annual mean percentage change since then of  $\pm 2.7$  percent. This sense of overall stability, however, disguised a state of constant internal flux.

The turmoil underlying the relatively constant overall stability is characterized by a high rate of nonrenewed licenses cancelling new licenses in an aggregate analysis of the industry. This, then, results in a near constant overall total.

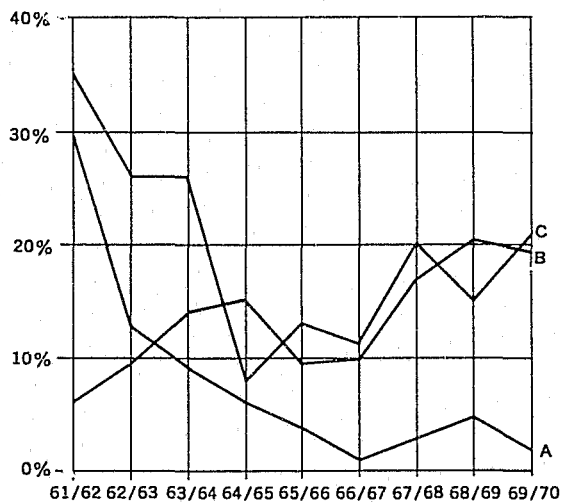
From 1961 to 1970, an average of 13.5 percent of all licenses issued in any one year in the jukebox industry expired, and an average of 17 percent of all licenses granted were new licenses for machines not previously licensed by the given licensee. In the amusement device industry, an average of 11.6 percent of the licenses expired while an average of 19 percent of the new licenses were new. For 1963-1969, the average rates of license expiration and new license issuance are, for jukeboxes, 15.1 percent and 16.3 percent, respectively; for the amusement devices, 11.6 percent and 12.7 percent, respectively; thus reflecting an overall appearance of stability in both the jukebox and amusement device industries. This similarity

of percentage increases and decreases from 1963 to the present suggests further that the same machines are being licensed by different operators. In other words, licenses for what are, in effect, the same machines were being transferred among licensees. Although the physical machine may be different, their locations are not changing significantly.

The rates of internal turnover as compared to the gross trend of overall stability are displayed, on an annual basis, in Exhibits 8 and 9. A separate graph is presented for each industry, and on each graph three lines are displayed. Line A graphs the rate of percentage change in the total number of machines licensed in the industry from one year to the next. Line B graphs the aggregate number of licenses allowed to lapse by operators as a percentage of the number of licenses granted in a given year. Line C graphs the aggregate license in the number of licenses granted to given operators in a given year. It is to be noted that the trends within the two sectors are nearly identical, suggesting that both are affected by the same internal and external sets of circumstances.

This high rate of annual internal turnover is suggestive of two competing hypotheses: One,

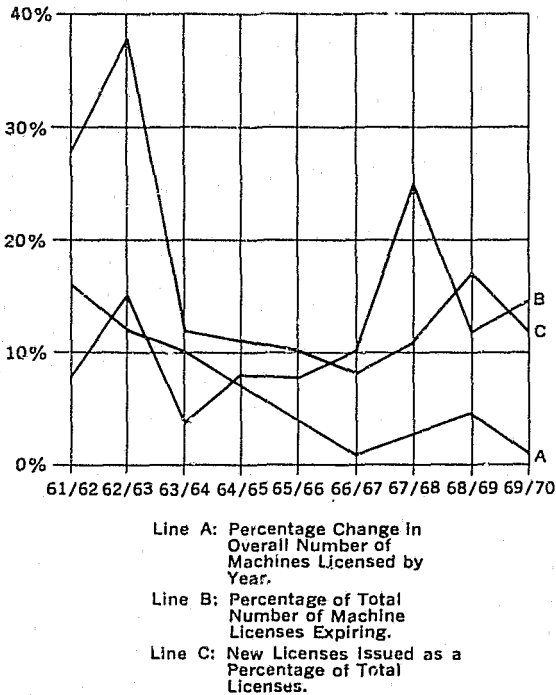
EXHIBIT 8.—Aggregate Turnover in Jukebox Industry



- Line A: Percentage Change in Overall Number of Machines Licensed by Year.
- Line B: Percentage of Total Number of Machine Licenses Expiring.
- Line C: New Licenses Issued as a Percentage of Total Licenses.



EXHIBIT 9.—Aggregate Turnover in Coin Amusement Device Industry



that each industry is either highly competitive with licenses changing hands each year due to aggressive, honest entrepreneurship or, two, that the rate of license turnover is due to business extortion. It is the second hypothesis, that of prevailing business extortion, which is most supported by further analysis.

*Analysis of the Jukebox and Amusement Device Industries*

Each industry was stratified into five tiers, each tier representing different types of vending machine operations in the industry. As described previously, the tiers represented machine operators having:

- 1-3 licenses,
- 4-9 licenses,
- 10-29 licenses,
- 30-99 licenses, and
- 100-999 licenses.

As explained above, in a stable industry generally characterized by aggressive competition, such as vending machines, small operators are more vulnerable than large ones, and large operators often obtain their gains from the small operators. If this were the case, where licenses are being transferred, small operators would

register a high percentage of losses and a low percentage of gains, while the medium and large operators should register fewer losses and show high rates of gain. Thus, losses should be low for the large operators and higher for the medium and small operators, and gains should be high for the large operators and lower for the medium and small operators. This, however, is not the tendency observed in Detroit.

To determine the characteristics of license turnover in the jukebox and amusement device industries, we moved from the aggregate distributions presented in Exhibits 8 and 9 to disaggregated distributions.

Exhibit 10 consists of a set of graphs, one for each industry tier, each of which displays three lines for each sector tier. Line A represents the percentage of the industry controlled by that licensee category from 1960 to 1970; Line B, the percentage of total losses accrued to that category in each year; and Line C, the percentage of total gains accrued to that category in each year. An examination of these sets of graphs results in the following three generalizations which are applicable to both jukebox and amusement device licenses.

1. Since 1963, the percentage of the industry controlled by each category of licensee has remained relatively constant.
2. The percentage of losses accrued to each category of licensee is very close to the percentage of the industrial sector controlled by licensees in that category, indicating that license losses were random with no regard to an operator's competitive position.

EXHIBIT 10.—Disaggregated Turnover in Jukebox and Coin Amusement Device Industry

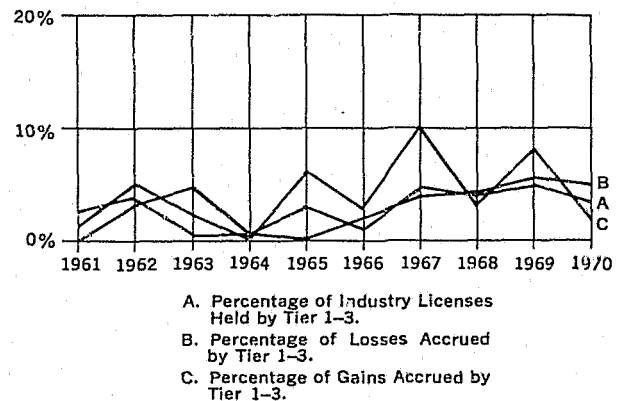
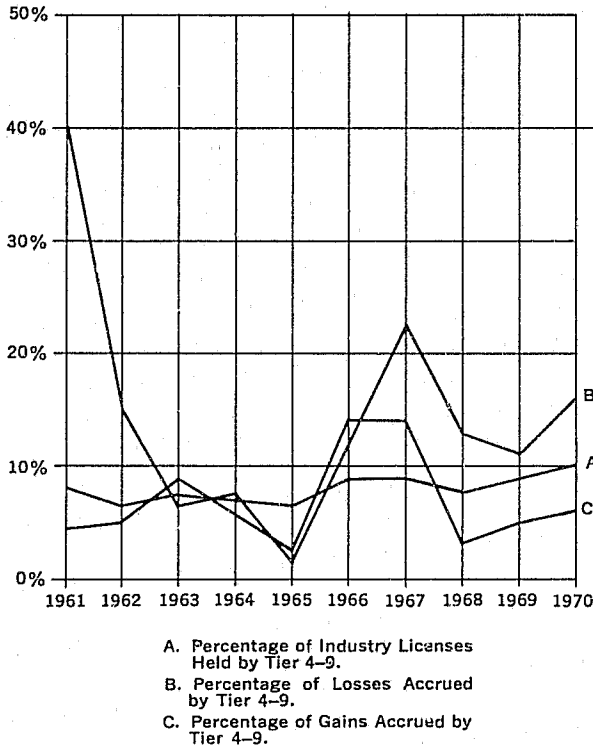


EXHIBIT 10.—(contd.)  
JUKEBOX LICENSES—4-9 LICENSES

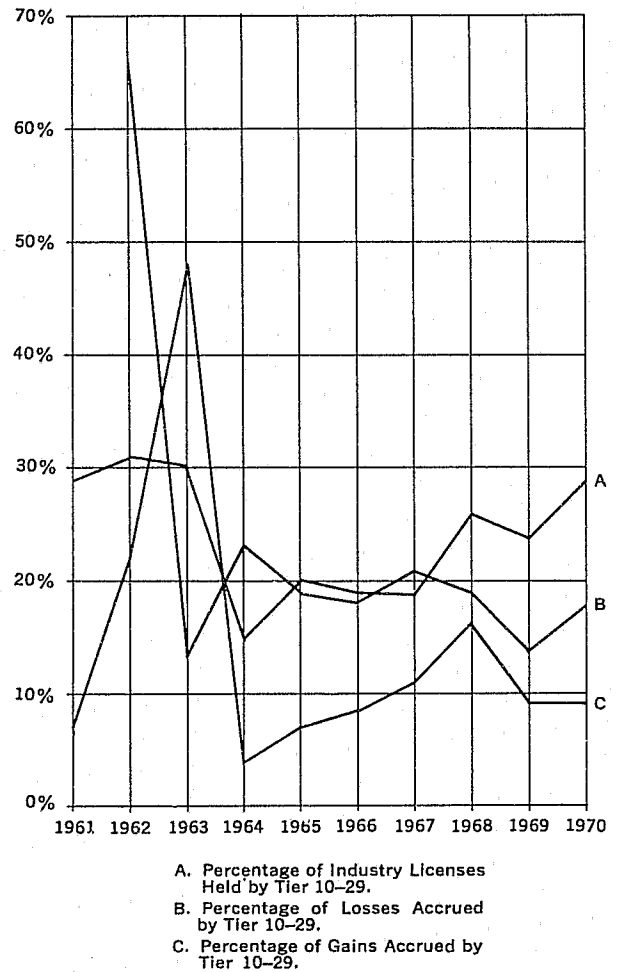


- The percentage of new licenses accruing to each of the categories is appreciably lower than the percentage of the industrial sector controlled by licensees in that category, and the magnitude of the difference between percentage of gains and percentage of industry controlled increases as the size of the operation represented by each category increases.

These three generalizations run directly contrary to predicted results in a normal competitive market and are suggestive of abnormal business operations.

The hypothesis that normal competition would result in these patterns is further undermined and that of business extortion reinforced by the distribution of the new licenses issued in each year. On the average, 41 percent of all amusement device licenses issued each year were issued to people who were outside of the industry in the previous year; for the jukebox sector, 54 percent of all licenses went to new operators. The distribution of machines across categories of new operators is also instructive. Of all new machines licensed in the jukebox

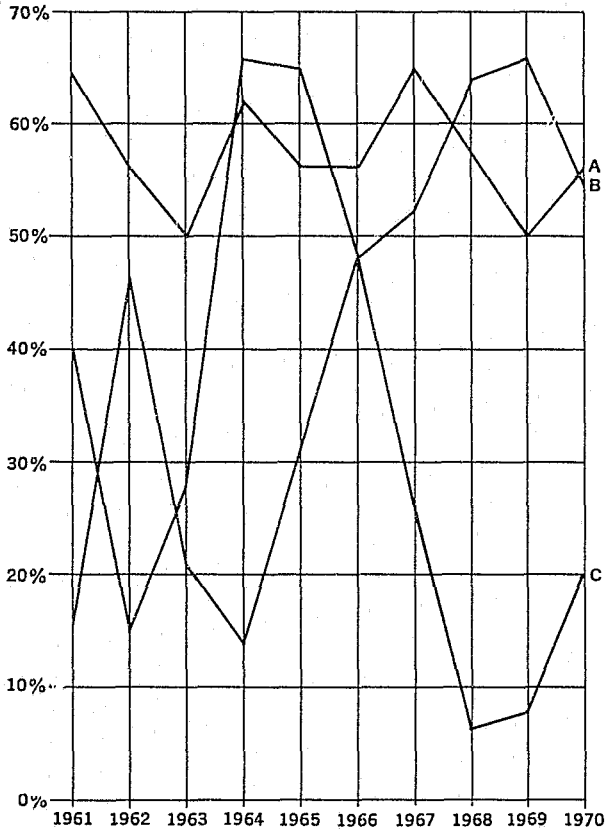
EXHIBIT 10.—(contd.)  
JUKEBOX LICENSES—10-29 LICENSES



sector from 1961-1970, 72 percent were licensed by operators having more than ten machines in their first year of operation. In the amusement device sector, 81 percent went to such operators.

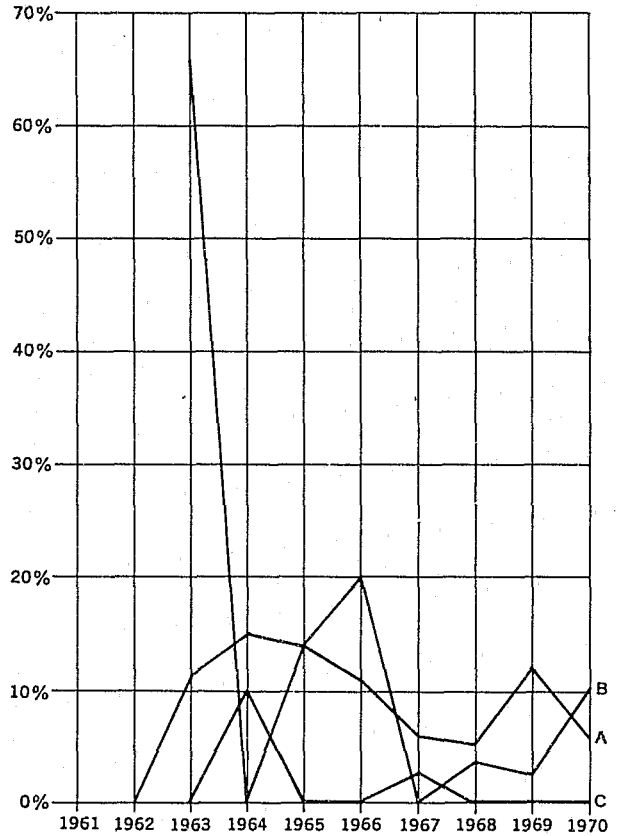
This pattern of a majority of new licenses accruing to large, new operators is contradictory to the suggestion of an intensely competitive, legitimate market pattern. In a competitive stable market the predominant number of new licenses would be expected to accrue to the larger, long-standing operators, as they would hold a competitive advantage over smaller operators and certainly over individuals starting new businesses. Under normal circumstances, new operators would find it difficult to offer for each of six years a competitive advantage to achieve success like that being experienced. However, competitive advantage in

EXHIBIT 10.—(contd.)  
JUKEBOX LICENSES—30-99 LICENSES



A. Percentage of Industry Licenses Held by Tier 30-99.  
B. Percentage of Losses Accrued by Tier 30-99.  
C. Percentage of Gains Accrued by Tier 30-99.

EXHIBIT 10.—(contd.)  
JUKEBOX LICENSES—100-999 LICENSES



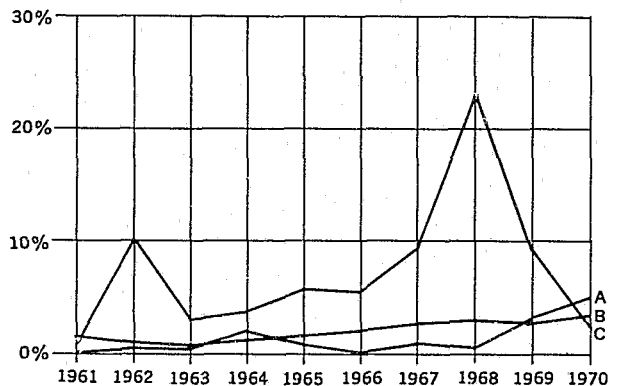
A. Percentage of Industry Licenses Held by Tier 100-999.  
B. Percentage of Losses Accrued by Tier 100-999.  
C. Percentage of Gains Accrued by Tier 100-999.

a case like this could be obtained through extortion practices.

The phenomena described are, therefore, suggestive of organized criminal activity in the form of small business extortion carried out along the following lines:

1. Individuals on whose premises jukeboxes and amusement devices are located are forced to turn the operation of the machines over to a given extorting new licensee or ongoing operator. The extortion is carried out, therefore, without regard to the nature of the vending machine company servicing the machine and losses are consequently random across categories of operations.
2. The extorted licenses are distributed to several "dummy" firms set up to dis-

EXHIBIT 10.—(contd.)  
COIN AMUSEMENT DEVICES—1-3 LICENSES



A. Percentage of Industry Licenses Held by Tier 1-3.  
B. Percentage of Losses Accrued by Tier 1-3.  
C. Percentage of Gains Accrued by Tier 1-3.

EXHIBIT 10.—(contd.)  
COIN AMUSEMENT DEVICES—4-9 LICENSES

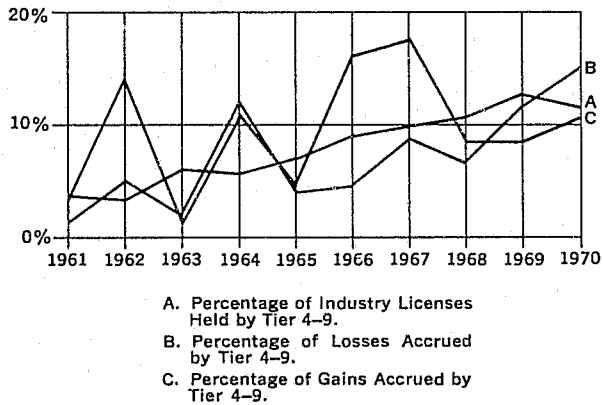


EXHIBIT 10.—(contd.)  
COIN AMUSEMENT DEVICES—10-29 LICENSES

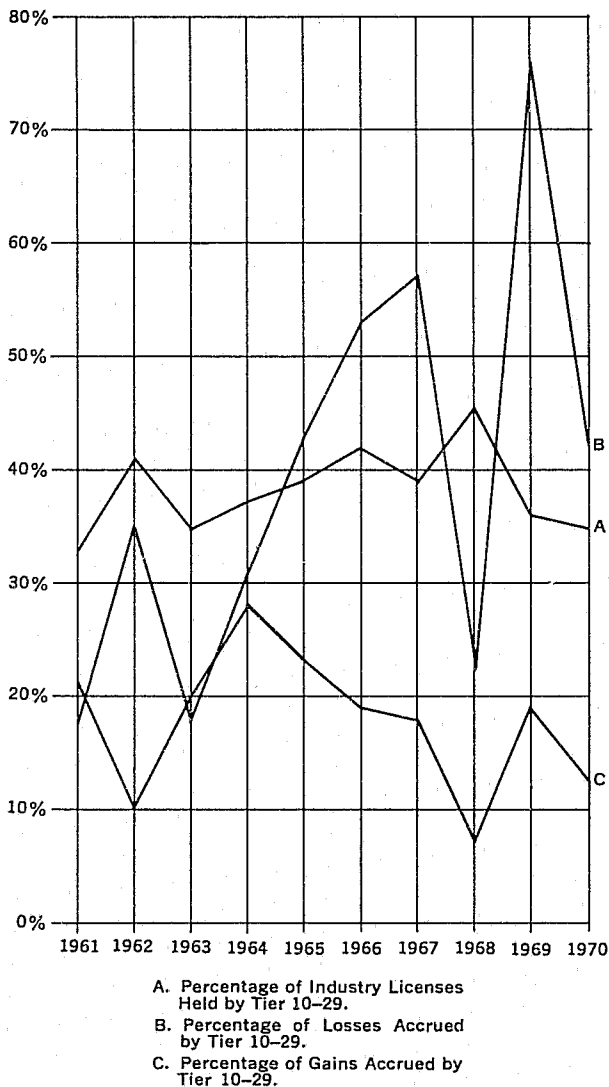
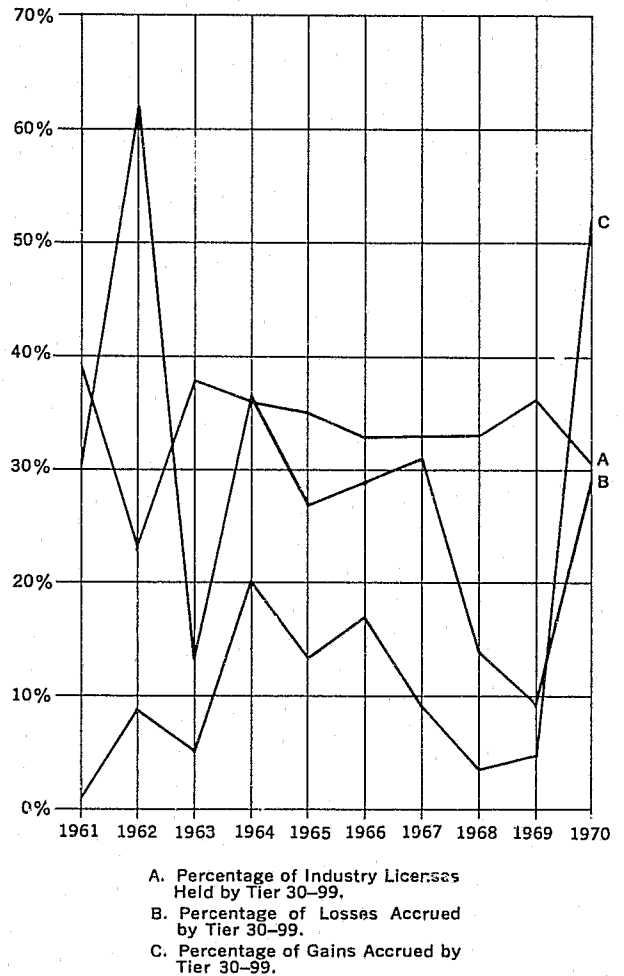


EXHIBIT 10.—(contd.)  
COIN AMUSEMENT DEVICES—30-99 LICENSES

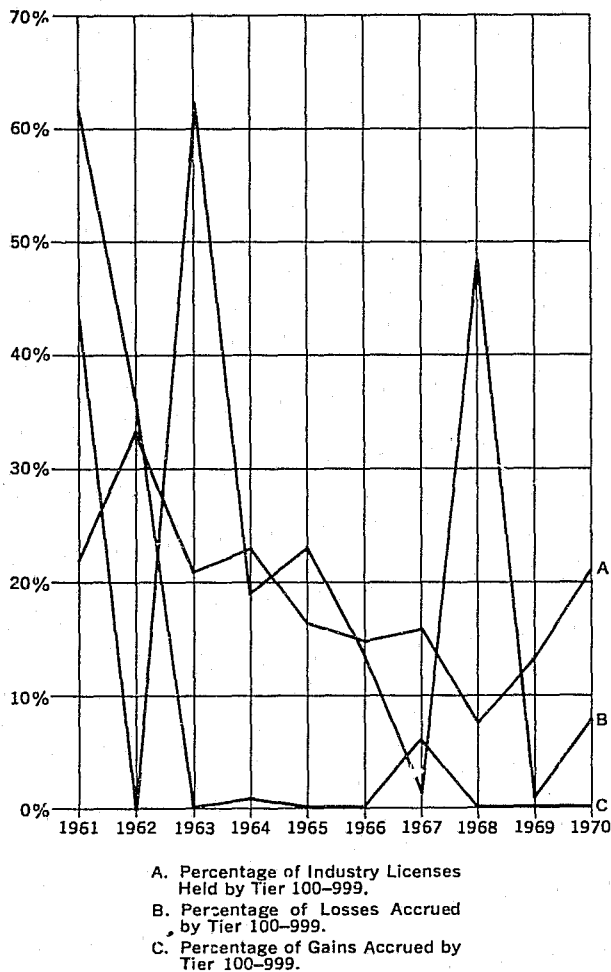


guise the singularity of criminal control of the industry.

3. The "dummy" operators either show a single large jump in the number of machines licensed, or come into business with an abnormally high number of machines in their first year of operation.
4. After the "dummy" operator is set up with a large number of machines, his overall size is allowed to fluctuate with the market, registering insignificant losses and gains through time.

Due to the random extortion practices and the wide distribution of machines among the "dummy" operators, the overall distribution of machines across categories of licensees remains relatively constant and the industry appears, on the surface, relatively undisturbed.

EXHIBIT 10.—(contd.)  
COIN AMUSEMENT DEVICES—100-999 LICENSES



*Identification of Extorter*

In the context of the Detroit study, the identification of those firms thought to be benefiting from extortion practices was not conducted in the formal manner described in the first section; it was initially conducted in a subjective manner. Seven firms were identified as possible extorters, five of which had holdings ranging from 22-45 machines in their first years of operation, two of which showed sudden growth of, respectively, 22 and 28 machines in a single year, and then maintained their increased holdings through time. Upon development of the formalized system for identification, the first five were yielded as "extorters" in the same manner. They had typically large

holdings in their first year of operation; the second two had normalized indexes of growth of, respectively, 7.3 and 9.3.

The determination of locations extorted was accomplished by studying the information on location holdings for the alleged extorters. Data for two years was studied, and fifteen locations which in the previous year were serviced by firms with normal patterns of growth were selected as extorted locations. Field investigations have on the basis of this information been initiated.

**D. Implementation of Methodology**

Should the analysis be conducted manually, it would be an extremely time-consuming, if not impractical, procedure. The study presented here was conducted using a Honeywell 1648 computer, a small- to mid-range machine, and a low-speed teleprinter. The programs developed could be adapted for use on any small machine, and the output is designed to be easily readable. To conduct the analysis, using the computer and designed programs, a reconstruction of the Detroit study would require the following manpower commitments:

|                             | <i>Manpower Requirements</i>  |
|-----------------------------|-------------------------------|
| Step 1: Coding of data.     | 6 man-days clerk.             |
| Step 2: Punching of data.   | 2 man-days keypunch operator. |
| Step 3: Analysis of output. | 1 man-day trained analyst.    |

The computer analysis, using the designed programs, requires 45 minutes of computation time on the Honeywell 1648 computer, and 125 minutes of print time on a low-speed printer. The cost of this computer, as used by IR&T in conducting the study is \$20,000.

**E. Monitoring and Self-evaluation**

The licensing data used to conduct the analysis is available annually. That aspect of the analysis which is descriptive of general market patterns is, itself, a monitoring and evaluation device. When extortion occurs to upset normal patterns of market behavior, law enforcement efforts can be judged effective to the degree to which the market responds. When the appearance of abnormality diminishes, when the market manifests normal, expected patterns of behavior, the law enforcement activities can be adjudged effective.

## VII. CASE STUDY: LABOR RACKETEERING

### A. Hypothesis and Methodological Guidelines

The amount of money from dues and income-producing investments which flow through labor unions, the methods by which labor union officials and administrators are selected, and the regulations which control labor union administrative practice provide opportunities for misusing or abusing the resources of labor unions. Disproportionately high fees and administrative costs could indicate managerial inefficiencies due either to questionable, although legitimate, business practice. High costs could also identify criminal practices where concerted attempts are being made to misuse funds. Fund misuse here is hypothesized to be, generally, the purchase of services or the paying of salaries which are not related to legitimate labor union activities. The purchase of services, ranging from building maintenance to labor-management consultants, at inflated prices would be a convenient way to pay for favors already received or about to be received, or to provide monies to individuals or groups for their own use or for investment in either criminal or noncriminal enterprises. The same situation applies to the paying of inflated salaries. In some cases, the purchase price or salary may be paid with no intention of receiving any legitimate service.

Changes in investment portfolios could also be indicative of organized criminal activity. Unexplained changes in a labor union's portfolio might identify violations, or corrections of violations, of either a fiduciary responsibility or criminal law. Rapid shifts in assets, such as from cash or Treasury Bills to unsecured loans or speculative investments, might identify situations where the decision by union officials or trustees to move into a more risky investment situation was influenced by some form of pay-off or blackmail.

Deposits of large amounts of cash in noninterest-paying accounts (e.g., checking accounts) might identify at least a conflict-of-interest situation where, for example, union

officials might be board members of the bank in question.

Changes in the pattern of administrative expenses or portfolio makeup might also identify the results of actions to correct either managerial or criminal problems. A decrease in administrative costs, for example, might identify either the implementation of more efficient managerial practices or the removal of certain criminal influences.

Labor unions file an annual financial report, Form LM-2, "Labor Organization Annual Report," with the U.S. Department of Labor, which itemizes labor union assets, liabilities, receipts, and disbursements. The names of officers, business agents, and employees are listed, along with their annual compensation. Analysis of certain deduced relationships among various financial items on Form LM-2 form the basis for the methodology. Some hypothesized relationships might be:

- dues income should at least equal expenditures,
- administrative costs should be less than dues income, and
- a portion of a labor union's cash should be in interest-bearing accounts.

By plotting financial indicators for the past five to ten years for labor unions in a given jurisdiction, patterns may be seen which identify shifts in the degree to which a labor union is influenced by questionable or criminal practices. Some of these shifts, identifiable by this method as of the year of filing of the significant data, may actually have taken place as long as several years before conventional intelligence operations identified the change. If these patterns exist historically, then certain rules can be developed for an examination of current union financial practices. If, for example, the embezzlement of union funds was discovered three years after the ratio of dues income to expenditures became greater than one, then the index  $\frac{\text{Dues Income}}{\text{Expenditures}}$  should be plotted annually for each labor union.

If the index rises above one, then further inquiry into the union's management might be appropriate.

Other indicators may also be monitored which do not have any known historical links to changes in criminal activity, but which, in themselves, suggest misconduct. One example of an indicator which might be monitored is asset depletion; as assets are depleted, further inquiry into the union's management might be warranted.

Analysis of labor union financial records only makes it possible to identify situations which are suspicious, due either to an historical relationship between an indicator and an event, or to the inferences to be drawn from changes in an indicator, or to identify events which were suspicious and are now being corrected. Investigative resources can then be directed according to shifts in indicator trends. Also, since the information on disbursements and expenditures is factual, it may provide the basis for grand jury examination.

It is emphasized, however, that the monitoring of shifts in indicator trends is of primary use in directing the focus of investigations and in monitoring the pattern of criminal activity during and after the investigation and subsequent enforcement actions.

## B. Summary Procedures

Listed below are the methodological steps which were described above in context with one description of labor racketeering.

1. Identify labor unions to be analyzed. Selection criteria can include location of unions, known backgrounds of officers, and size of union.
2. Obtain for the past eight to ten years the annual reports, Form LM-2, "Labor Union Annual Report," of each labor union from the U. S. Department of Labor.
3. Define indices to be plotted, such as  

|                         |                            |
|-------------------------|----------------------------|
| Administrative<br>Costs | Speculative<br>Investments |
| Dues income             | Total Assets               |

and liquidity. (The following case study examines a number of indices.)
4. Compute and plot indices.
5. Identify shifts and perturbations in indicator trends which follow, proceed, or

are coincidental with known changes in criminal activity which affected organized labor.

6. Set up procedure to monitor these historically relevant indicators for each labor union annually.
7. When historical shifts are repeated which coincided with changes in criminal activity in the past, commit investigative resources.
8. Where shifts in indicators indicating misconduct in themselves occur, commit investigative resources.

Once indicators are developed which either have historical links to organized crime or are directly indicative of misconduct, it would be possible within various enforcement agencies to design a system which could then be maintained by relatively junior and inexperienced staff. Shifts in trends could then be submitted to intelligence operations for complete analysis.

The next section describes the application and testing of these steps. The sections that follow it identify the resources required to implement and maintain a system to identify possible changes in the way organized crime affects labor unions.

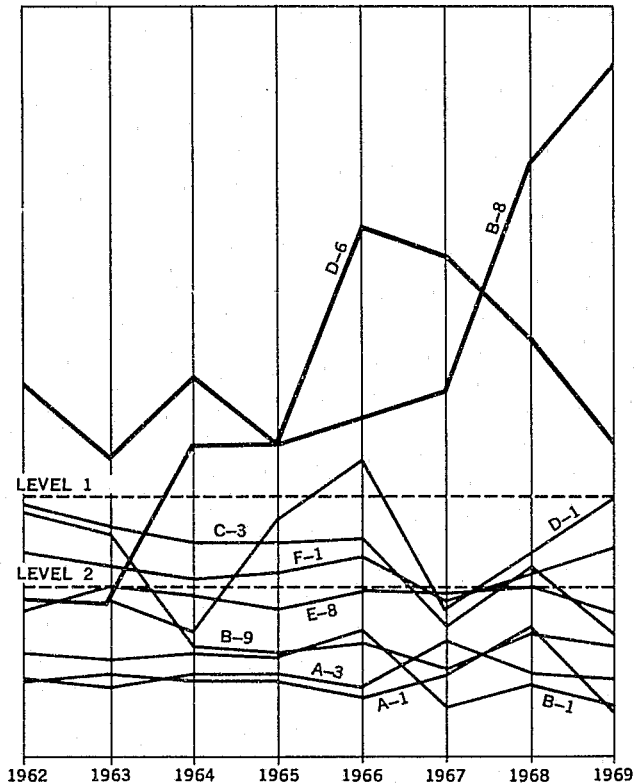
## C. Analysis of Indicators of Labor Racketeering

This analysis was furnished to a state organized crime strike force. Upon review, state prosecutors concluded that state constitutional prohibitions presented obstacles to prosecutions under state labor laws. Federal labor officials asserted that abuse of union funds was not a violation of Federal labor laws. Legal research continues to determine whether abuse of union funds can be reached under state or Federal antifraud legislation. A number of enforcement officials commented upon the proposed methodology and the results of the analysis.

Financial data was collected and analyzed for 32 labor unions, representing six general occupational or industrial categories. The following code will be used to identify each union:

- Each occupational or industrial category is represented by a single capital letter: A, B, C, D, E, or F.
- Each category code is followed by a number which identifies a specific union.

EXHIBIT 11.—Labor Unions  
Administrative Cost Dues Income



For each of the unions, indicators dealing with administrative expenses and asset utilization were computed, plotted, and analyzed.

#### Administrative Costs

Exhibit 11 plots the index  $\frac{\text{Administrative Costs}}{\text{Dues Income}}$

for 10 of the 32 unions. (The vertical scale has no units, so as to avoid the identification of the specific labor unions which were analyzed.) The administrative cost figure is derived by adding together the following expenditures: salary paid to union officers, salary paid to union employees, educational and publicity expenses, office and administrative expenses, and benefits. Only these components are used, as they account for the bulk of administrative expenses and are considered to be those which would vary sharply if the administrative budget is being used improperly or, conversely, if improper actions are corrected.

After the data was plotted, it was necessary

to establish a "normal" relationship between Administrative Costs and Dues Income. As eight of the ten unions show Administrative Costs/Dues Income below "level 1," this on first inspection might seem to be the permissible upper limit. Such a limit would suggest that only two unions, B-6 and D-6, sustained abnormally high administrative costs. This upper limit, though, is not satisfactory because at "level 1," administrative costs are consistently greater than dues income. A consistent pattern of expenditures significantly exceeding dues, particularly since administrative expenses are only part of a labor union's expenses, on its face suggests mismanagement.

These conclusions seem logical, and are substantiated by the performance of one particular union, D-6. In 1968, this union's pension fund was reorganized as a result of criminal indictments having been brought against its trustees. One effect upon the local union was that the index  $\frac{\text{Administrative Costs}}{\text{Dues Income}}$  was halved from 1968 to 1969.

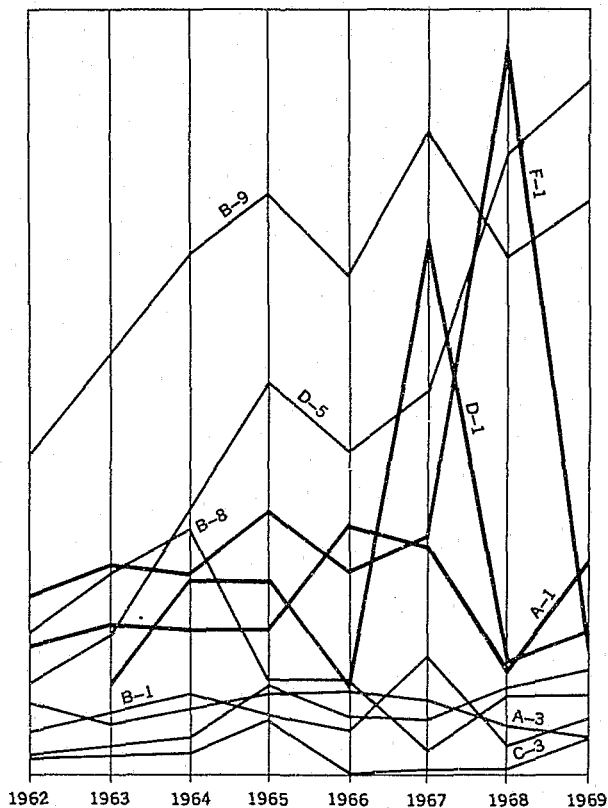
Two factors, that a ratio of administrative costs to dues income greater than one means that union expenses are greater than receipts, and that this ratio did decline for a labor union involved in criminal indictments, suggest that the upper parameter should be less than one. This seems to be appropriate as five unions, A-1, B-1, B-9, E-8, and A-3, all except one presumed to be relatively unaffected by organized crime, have this index below "level 2" which is below a ratio of one for Administrative Costs vs. Dues Income.

Setting the upper limit for normal operating costs at "level 2" would therefore indicate that high operating costs are incurred by C-3, F-1, D-1, and E-8. This reinforces the initial assertion that the operating costs of D-5 and B-6 are at an unwarranted high level. The implication could be that high administrative expenses are required to support irregular activities.

For the foregoing reasons it appears that the index  $\frac{\text{Administrative Costs}}{\text{Dues Income}}$  is an indication of changes in criminal or managerial misconduct and is a simple and inexpensive source for investigative leads.



**EXHIBIT 12.—Labor Unions  
Cash and Demand Deposits  
Average Monthly Expenditure**



### Asset Utilization

Exhibit 12 graphs the index  
Cash and Demand Deposits  
Average Monthly Expenditures

for ten unions. As with union pension and welfare plans, this index is designed to monitor "reasonable" or "acceptable" managerial and financial practices. Average monthly expenditures for each year are computed by dividing total yearly expenditures by twelve. Four unions, C-3, B-1, E-8, and A-3, show a liquidity position consistently well below the others. These indices are well below the suggested "optimum" liquidity position of liquid assets averaging 150 percent of average monthly expenditures. As suggested earlier in the analysis of welfare and pension plans, this high liquidity means that potential income from interest-bearing accounts is being lost.

A fifth union, B-8, registered a high cash position prior to 1964, but since that time has

dropped to a level consistent with the above four.

The remaining five unions, A-1, D-1, D-6, and F-1, register extremely high cash positions which fluctuate and are almost double the 150 percent cash position considered necessary and prudent.

Labor union A-1 fluctuates between almost double and triple the 150 percent cash position. Labor union D-1, for 1967, shows an increase in liquidity greater than five times the 1966 liquidity position. Close scrutiny may be warranted of D-1's 1967 activities, along with the policies, either internal or external, which resulted in the rapid increase in liquidity, followed by a decrease. Labor union F-1 also showed a rapid rate of increase in the ratio of cash to average monthly expenditures, resulting in a 1968 high almost ten times greater than the necessary 150 percent liquidity position. Although a considerably lower position was registered in 1969, the liquidity position has been consistently high and, therefore, close investigation into management practices may be warranted.

The two remaining unions, D-5 and B-9, have both shown an uninterrupted increase in the ratio of cash to average monthly expenditures. One union, D-5, registered almost a 1,000 percent increase from 1962 to 1969, with the 1962 level already 400 percent greater than necessity. The position of neither union can be easily justified by accepted management practices.

Some of the noticeable sharp decreases, particularly those registered by F-1 from 1968 to 1969, D-1 from 1967 to 1968, and A-1 from 1967 to 1968, can be attributed to an increase in enforcement activity.

This index of asset utilization also appears to monitor changes in criminal or questionable activity.

### D. Implementation of Methodology

A major problem in this investigation was to determine which federal, state, and local laws were being violated in order to allocate investigative and prosecutorial personnel. This problem arose from the fact that it is not illegal, for example, to spend more money than comes in, maintain large amounts of money in non-interest paying accounts, or invest in specula-

tive real estate ventures unless these actions are done with illegal intent. For example, analysis of Form LM-2, which is required by Federal statute, may identify inflated payments for certain services. This may not be a Federal violation, but it may be a violation of state fraud or embezzlement statutes. This problem is now being examined by lawyers in a local prosecutor's office.

Other problems which were confronted, and the way they may be dealt with now, are summarized below:

1. Considerable time had to be spent in becoming acquainted with labor union reporting requirements, the locations of files, the methods required to obtain LM-2's, and some of the subtleties involved in reporting. This effort would not have to be duplicated, as the general method has been demonstrated.
2. All indices were computed and plotted by hand, requiring considerable time. The historical analysis of indicators could be better prepared by a computer.
3. Obtaining knowledge of past organized criminal influence upon labor unions required the establishment of credibility and trust with a number of law enforce-

ment officials. This sensitive information could be readily obtained by law enforcement officials.

The initial analysis of the 32 labor unions required several man-months. This included obtaining and gaining understanding of the Form LM-2's and the computing and plotting of indices. This work was accomplished primarily by research assistants after the forms were obtained; future work could be accomplished by clerks. Relating historical shifts in trends to organized crime and evaluating indices which were developed to measure changes in criminal or irregular behavior required between one and two man-months of senior-level analysts. This, too, would not have to be duplicated as enforcement officials in a given jurisdiction would be familiar with the historical background of organized criminal influence on local labor unions.

Determining how to use this information in investigations and prosecutions required less than one man-month. At this point, research is underway to determine if local fraud cases can be made.

In summary, an estimate of the time and personnel category now required to analyze five indicators for 25 labor unions *without use of a computer* is:

|   | Manpower Requirements  |
|---|--|
| Step 1: Obtain LM-2's for selected labor unions and outline analysis.   | 1 man-day enforcement official;<br>2 man-days research assistant;<br>1 man-day clerk.                                    |
| Step 2: Compute indices, and plot historical data.  | 3 man-days research assistant;<br>15 man-days clerk.   |
| Step 3: Obtain data on past influence of organized crime upon labor unions, and relate to shifts in trends.         | 1-5 man-days enforcement official;<br>1-5 man-days research assistant;<br>1-5 man-days clerk.                            |
| Step 4: Select indices for continued analysis.  | 1-2 man-days enforcement official;<br>1-3 man-days research assistant;<br>1-3 man-days clerk.                            |
| Step 5: Allocate investigative personnel based on historical shifts in indicator trends.                            | Unknown.   |
| Step 6: Develop hypotheses for new indicators for future analysis, and annually compute indices, plot, and analyze. | 1-10 man-days enforcement personnel per year; 10-20 man-days research assistant per year; 15-25 man-days clerk per year. |

A system for the analysis of financial indicators of labor unions can be designed with the allocation of 28-51 man-days and operated with 26-81 man-days per year. If the data from the LM-2's were fed into a computer and a few simple programs written, hundreds of indices

for many more than 25 labor unions could be analyzed in far less time.

This analysis could require even fewer law enforcement resources if businessmen, citizens groups, and leaders of the labor movement were to monitor the financial and business practices

of labor unions. The encouragement of this activity would have to be based upon local conditions.

#### E. Monitoring and Self-evaluation

The examination of LM-2's should provide a deterrent to organized criminal activity as new information is being obtained upon which to base investigative and prosecutorial decisions. Pressures resulting from a systematic analysis should at least result in changes of the methods by which organized crime affects labor unions. This can probably be readily monitored by knowledgeable law enforcement officials.

In the examination of historical data and relationships, efforts should be made to determine specifically what events or phenomena occurred which may have caused a trend to shift. In many cases, a shift can be attributed to perfectly legitimate events such as a strike, which may deplete a strike fund, or participation in a new insurance plan, which may raise administrative costs. Other shifts may be attributable to changes in the scope and incidence of criminal activities. These changes can re-

sult from law enforcement activities, such as investigations and prosecutions, or agreements or conflicts among criminal interests, such as negotiating a new sweetheart contract or purchasing unneeded services. These and other past events should be understood by law enforcement officials. As indicators are plotted from current LM-2's, shifts which are similar to historical shifts should be studied to see if they signal a repeat of the event which occurred in the past or possibly a new event linked to organized criminal or legitimate activities. This process of identifying relationships between indicator trends and events, particularly those which have occurred in the past, is important as it aids in the identification of the forces which affect the degree to which labor unions are influenced by organized crime.

Other indicators which are studied may only have intuitive or deductive value; that is, their historical trend shifts are not readily attributable to any known events. An indicator of this type might be asset depletion, as rapid loss of assets should at least be a reason for inquiry. Indicators of this type can readily be deduced, hypothesized, and examined.

## VIII. CASE STUDY: LABOR UNION WELFARE AND PENSION PLAN FRAUD\*

### A. Hypothesis and Methodological Guidelines

The amount of money from employee and employer contributions and income-producing investments which flow through labor union welfare and pension plans, the methods by which plan officials and administrators are selected, and the regulations which control welfare and pension plan practices provide opportunities for misusing or abusing the resources of these plans. Disproportionately high fees and administrative costs could indicate managerial inefficiencies due to questionable, although legitimate, business practices. However, high costs might also indicate criminal misuse of funds. Fund misuse here is hypothesized to be, generally, the purchase of services, the paying of salaries, or the investment of union funds in ways which are not related to legitimate labor union activities.

The purchase of services, ranging from building maintenance to investment advice, at inflated prices, might be a payment for favors already received or about to be received, or a way to divert monies to individuals or groups for their own use or for investment in either criminal or noncriminal enterprises. Paying of inflated salaries might serve the same purpose. In some cases, the purchase price or salary may be paid with no intention of receiving any legitimate service.

Changes in investment portfolios could also indicate organized criminal activity. Unexplained changes in a labor union's portfolio might identify violations, or corrections of violations, of fiduciary responsibility or of criminal law. Rapid shifts in assets, such as from cash or Treasury Bills to unsecured loans or speculative investments, might identify situations where the decision by union officials or trustees to move into a more risky investment situation was influenced by some form of pay-off or blackmail.

Deposits of large amounts of cash in non-interest-paying accounts (e.g., checking

\*The methodology and basis for the case study on labor racketeering are quite similar to those described here.

accounts) might identify at least a conflict-of-interest situation where, for example, plan officials might be board members of the bank in question.

Changes in the pattern of administrative expenses or portfolio makeup might also identify the results of actions to correct either managerial or criminal problems. A decrease in administrative costs, for example, might identify either the implementation of more efficient managerial practices or the removal of criminal influence.

Analysis of asset growth rate might identify situations where investments are benefitting interests other than those of the plan participants. Lapses in an employer's payment of its negotiated share of employee Benefits may identify collusion between the employer and certain plan officials.

Welfare and pension plans file an annual financial report, Form D-2, "Employee Welfare or Pension Benefit Plan Annual Report Form," with the U.S. Department of Labor. These are public reports. Form D-2 itemizes pension plan assets, liabilities, receipts, and disbursements. The names of officers, business agents, and employees are listed, along with their annual compensation.

Analysis of certain deduced or intuitively derived relationships among various financial items on Form D-2 form the basis for the methodology. Some hypothetical relationships might be:

- There should be net asset growth.
- Administrative costs should be considerably less than contributions.
- Per capita employer contribution should not decline.

Plotting historical data on financial indicators selected on the basis of these assumptions for welfare and pension plans in a given jurisdiction may reveal shifts in the degree to which a plan is influenced by questionable or criminal practices. Some of these shifts may have taken place as

long as several years before conventional intelligence operations identified the change. If these patterns exist historically, then certain rules can be developed for the evaluation of current union financial practices. If, for example, the embezzlement of funds was discovered three years after the ratio of employer contribution to expenditures became less than one, then the index  $\frac{\text{Employer Contribution}}{\text{Expenditures}}$  should be plotted annually for each plan. If the index falls below one, then further inquiry into the plan's management would be appropriate.

Other indicators may also be monitored even without proof of historical links to criminal activity, because they suggest criminal misconduct. One example of such an indicator is asset depletion. As assets are depleted, further inquiry into the union's management might be warranted because it may be assumed that in a properly managed fund, even for a union with no membership growth, invested assets should grow.

Analysis of welfare and pension plan financial records makes it possible to identify situations which merit expenditure of conventional investigative resources by showing either a change in the direction of improper conduct or a change for the better in which a pattern of improper conduct is being reversed. Also, since the available information on disbursements and expenditures is factual and specifies such information as officers' salaries, it may provide direct assistance to conventional investigation.

It is emphasized, however, that the monitoring of shifts in indicator trends is of primary use in directing the focus of investigations, in monitoring the pattern of criminal activity during and after the investigation, and the effectiveness of subsequent enforcement actions.

## B. Summary Procedures

Listed below are the methodological steps for carrying out an analysis of welfare and pension plan fraud.

1. Identify labor unions to be analyzed. Selection criteria should include location of unions whose members are in the plan, known backgrounds of officers, and size of plan.

2. Obtain for the past eight to ten years the annual reports, Form D-2, "Employee Welfare or Pension Benefit Plan Annual Report Form," of each plan from the U. S. Department of Labor.
3. Define indices to be plotted, such as  $\frac{\text{Administrative Costs}}{\text{Dues Income}}$ ,  $\frac{\text{Speculative Investments}}{\text{Total Assets}}$ , and liquidity. (The following case study examines a number of indices.)
4. Compute and plot indices.
5. Identify shifts and perturbations in indicator trends which follow, proceed, or are coincidental with known changes in criminal activity which affected pension and welfare plans.
6. Examine annually these historically relevant indicators for each plan.
7. Where changes in indicators to change in criminal activity suggest the existence of criminal misconduct, commit investigative resources.

Once indicators are developed either based on historical links to organized crime or directly suggestive of misconduct, a current monitoring program could then be maintained by relatively junior and inexperienced staff. Shifts in trends could be submitted to intelligence operations for complete analysis.

The next section describes the application and testing of these steps. The sections which follow it identify the resources required to implement and maintain a system utilizing these procedures.

## C. Analysis of Indicators of Welfare and Pension Plan Frauds

This analysis has been used to develop investigative leads as part of an ongoing law enforcement effort, although investigations based on these leads have been held in abeyance pending a determination by Strike Force attorneys whether the wrongful conduct identified can be prosecuted under state fraud statutes or can only be rendered as a violation of federal labor legislation. A number of enforcement officials have commented upon the proposed methodology and the results of the analysis.

Nine pension plans and nine welfare plans were selected for this analysis. Pension plans are identified here as Plans P-1 through P-9, and welfare plans as Plans W-1 through W-9. Indices were developed in the following four areas: administrative expenses, employer contributions to the plan, asset growth rate, and asset utilization. The two which proved to be successful, administrative expenses and asset utilization, are discussed below.

*Administrative Expenses*

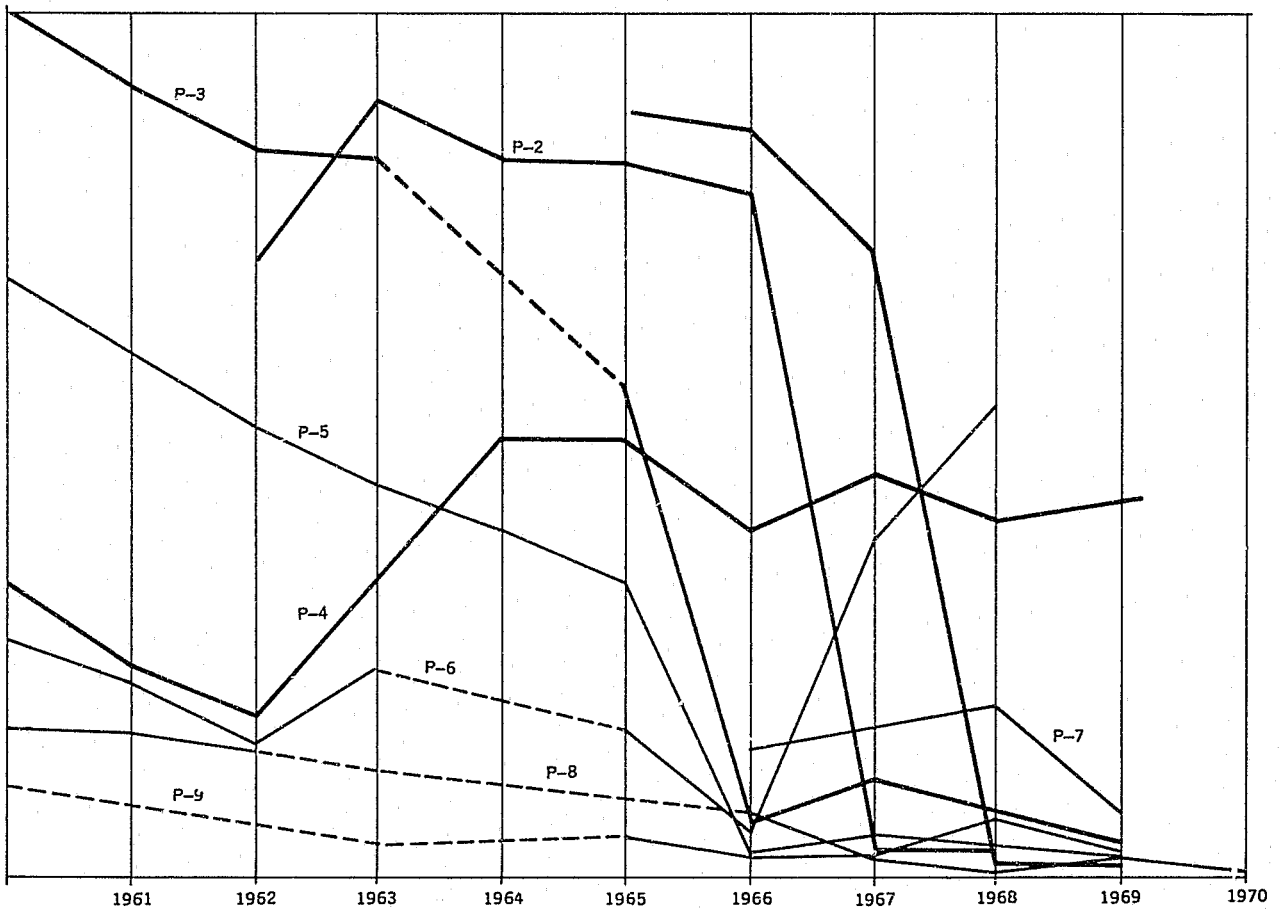
Two indices which monitor the level of administrative expenses were examined. They are:

- $\frac{\text{Administrative Costs}}{\text{Disbursements}}$
- $\frac{\text{Administrative Costs}}{\text{No. of Participants}}$

The first index,  $\frac{\text{Administrative Costs}}{\text{Disbursements}}$  was postulated on the basis that the ratio between administrative costs and disbursements should remain relatively constant. This assumes that a small increase in disbursements must be matched by a small increase in administrative costs. If the ratio of administrative costs to disbursements rises, however, this might suggest unwarranted increases in administrative costs, reflecting the misuse of plan funds. A steady decrease in this ratio might suggest at least more efficient managerial practices and, perhaps, a halt in the misuse of plan funds.

Exhibit 13 graphs the ratio of administrative costs to disbursements over time for the nine pension plans. This index shows declines for

**EXHIBIT 13.—Pension Plans  
Administrative Costs  
Disbursements**



P-1, P-2, P-3, and P-5 beginning in 1963. One pension plan, P-4, rose from 1962 to 1964 and since has remained fairly constant. This index, then, taken alone, may suggest that several of the plans, beginning in 1963, might have initiated more responsible financial and management practices. The trends upward may suggest fund misuse.

An individual familiar with the union pension plans in question has acknowledged that three of the pension plans, P-1, P-2, and P-3, did, in the years preceding their rapid decline, experience "extraordinary" financial practices. Although there was no law enforcement activity in the form of arrests, indictments, or prosecutions, investigations undertaken in 1963 and 1964 may have contributed to a decline in this index.

While this index does seem to identify several plans which significantly changed their financial managerial practices, there is an analytical problem which results from the accounting procedures required by Form D-2. Under the item "total disbursements," all expenditures for administration, benefits, and purchase of assets must be listed. Thus, the denominator of the ratio will itself fluctuate with each transfer of assets from one form to another; e.g., the selling of stock followed by the purchase of Treasury Bills, where the proceeds from the stock sale are used to purchase Treasury Bills. These transactions must be accounted for. The noticeable declines after past internal reforms in several plans, which may have resulted from pressures from enforcement agencies, appear to have some utility.

The second index dealing with administrative costs,  $\frac{\text{Administrative Costs}}{\text{No. of Participants}}$  is the plan's per capita administrative costs. As no empirical studies have established a "legitimate" or "normal" level of per capita administrative costs, it was necessary to identify possible causes of fluctuations in per capita costs. First, per capita administrative costs are high during the first several years of a fund's operation, but should decline as the "start-up costs" associated with the plan's first few years are paid or amortized, and second, economies of scale should lower per capita costs as the number of participants in the fund increases. The assumed lower level of per capita administrative costs,

after payment of start-up costs and realization of economies of scale, even when offset by increases in administrative costs due to inflation, should remain relatively constant from year to year. Legitimate factors which could result in a rapid increase in per capita administrative costs are a rapidly shrinking membership or a major shift in administrative practices, such as the installation of a computer. If this is the case, however, there should be a decline in the ratio after several years.

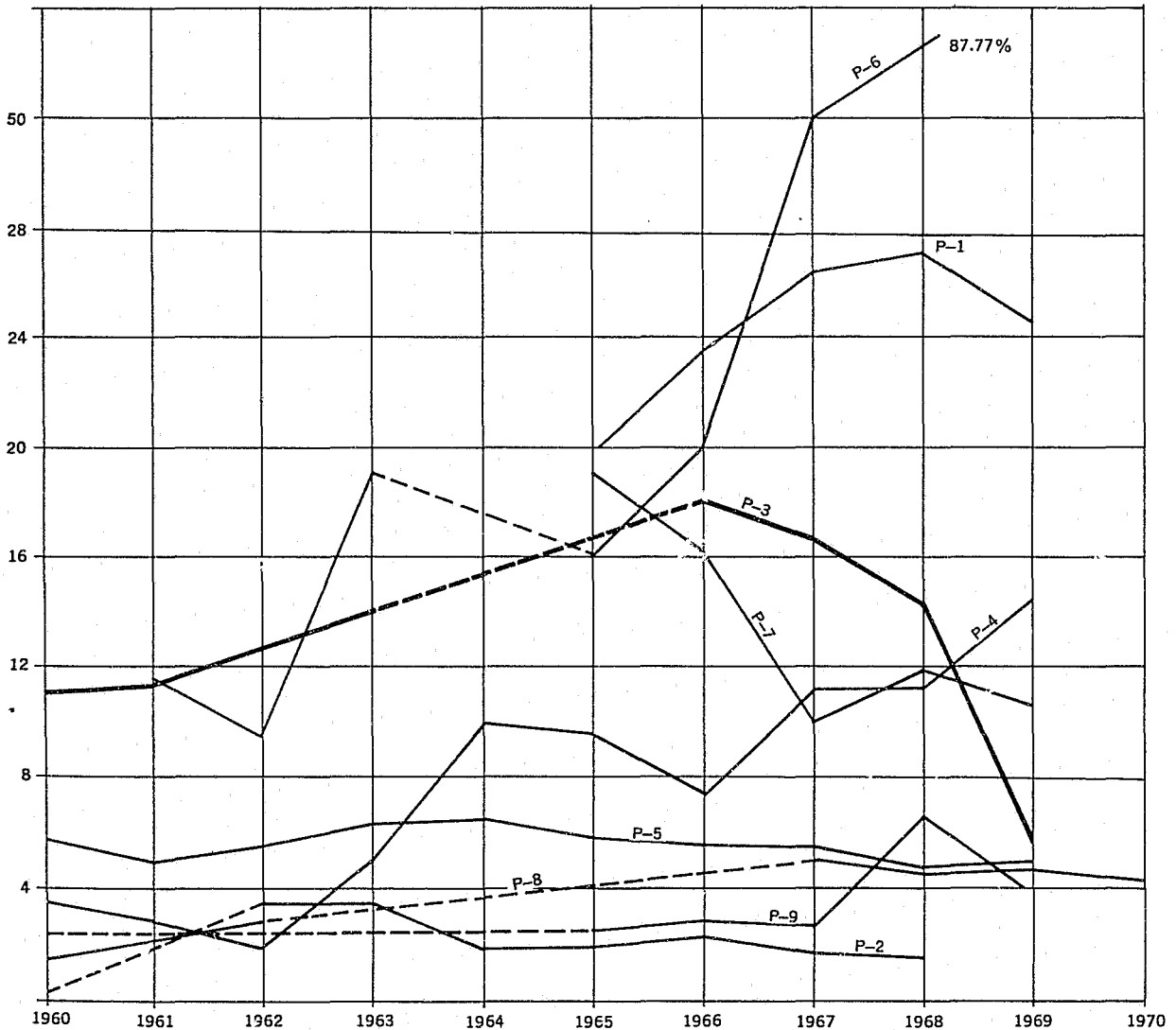
The per capita administrative costs of a pension plan should be lower, on the average, than those of a welfare plan. The differential in costs derives from functional differences. Whereas both pension and welfare plans need to manage their assets, pension plans dispense benefits on a more regular basis, while welfare plans distribute benefits erratically. Claims for welfare benefits require more verification and complex processing than pension claims.

Exhibit 14 graphs the per capita administrative costs as a function of time for the nine pension plans.

Four of the pension plans, P-5, P-8, P-9, and P-2, register per capita administrative costs less than \$7 since 1960. As there is convergence around the \$7 per capita administrative cost level, an initial assumption is that per capita costs around \$7 can be considered normal. The efficacy of this assumption is reinforced by the experience of a fifth plan, P-3. Until 1966, P-3 registered increases in per capita administrative costs from \$10.75 in 1960 to just above \$18 in 1966. In 1966, the per capita administrative costs began to register a small decline and fell to \$14.25 in 1968. In 1968, indictments were issued against the plan administrators, and management was changed. A new, presumably honest, fund came into existence, with the assets and administrative machinery of the old transferred. Per capita administrative costs for P-3 fell to \$5.75 in 1969, the year immediately following the indictments. We conclude from this analysis that aside from fund P-2 (otherwise suspected of improper practices), our hypothesis that continuing per capita administrative costs above \$7 are an indication of collusive misconduct and hence of organized criminal activity, and at least in the case of P-3 is verified.

This hypothesis focused attention on four

EXHIBIT 14.—Pension Plans  
Administrative Costs  
No. of Participants



plans, three of which are suspect. Pension plan P-7 registered a per capita administrative cost of approximately \$18.65 in 1965 and then registered a general decline along this measure. The 1969 per capita administrative cost was \$11. It is to be noted, however, that 1965 was the plan's first year of operation, which could account for initially high per capita administrative costs. The decline registered in the ensuing years could reflect the expected economies of scale. If the trend continues, the per capita administrative costs will fall to the \$7 level.

The three remaining plans, P-4, P-1, and P-6, all register steadily increasing, abnor-

mally high, per capita administrative costs. The P-4 per capita administrative costs have risen fairly steadily from \$2.15 in 1962 to \$15 in 1969. The rate of increase registered by P-6 has been more dramatic, rising from \$10 per capita administrative costs in 1962 to \$87.77 in 1968. The per capita administrative costs of P-1, for which figures are only available since 1965, rose from \$20 in 1965 to \$28 in 1968, then fell to \$24.50 in 1969. These per capita administrative costs suggest extraordinary practices. To a law enforcement agency, they might indicate a need for detailed investigation.

The index, per capita administrative costs



for pension plans, appears to have significant utility. In using it to evaluate future data, it will be necessary to weight it for inflation. It is also necessary in utilizing it to discount the short-term perturbations from significant management changes.

The analysis of the per capita administrative costs of welfare plans was conducted in a similar fashion to that of the pension plans. As discussed above, the anticipated "normal" per capita administrative cost is higher for the welfare plans than for the pension plans.

The analysis of the welfare plan per capita administrative costs suggests two possibilities as the upper limits of "normal" per capita administrative costs, as shown in Exhibit 15. The first is that per capita administrative costs under \$30 are reasonable, as six of the nine welfare plans are at this level. On the other hand, it is also possible to suggest that per capita administrative costs should fall under \$14 as is the case with W-6, W-7, W-8, and W-4. This line of reasoning would indicate that unusual financial practices were experienced by W-6 in 1968, and W-1 and W-9 since 1962.

Analysis of per capita administrative costs of welfare plans W-3 and W-5 permits the draw-

ing of specific inferences. The per capita administrative costs of W-3 rose steadily and rapidly from \$13 in 1960 to \$254.67 in 1969, suggesting some administrative difficulties. For W-5, the situation has been somewhat different. The rapid rise of per capita administrative costs from \$80 in 1960 to \$119 in 1963 has since been offset by a rather steady decline to the level of \$36 in 1969. This decline may be attributable to actions of law enforcement agencies.

Analysis of per capita administrative costs for both welfare and pension plans suggests that both rapid and steady increases, particularly above \$7 for pension plans and \$28-\$30 for welfare plans, are the result of unusual and questionable practices, although not necessarily illegal practices. A steady decline may be attributed to a self-initiated efficiency plan, influence of law enforcement agencies, or abatement of illicit practices.

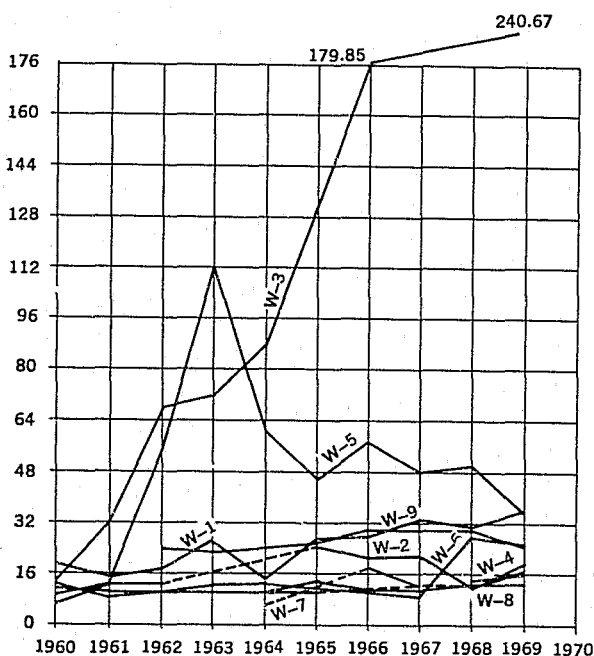
#### Asset Utilization

The index  $\frac{\text{Cash and Demand Deposits}}{\text{Average Monthly Expenditures}}$  is a measure of the cash position of the plan relative to expenditures. A generalized accounting rule for a private organization is that a cash balance greater than one and one-half times average monthly expenditures is seldom required. Maintaining a greater than necessary cash position results in unwarranted loss of income which could be derived from the investment of cash or savings deposits in interest-bearing accounts. A significant cash position also makes possible the misuse of funds with no noticeable decline in investment income. Thus, if the index registers a cash balance in excess of 150 percent of average monthly expenditures, there may be cause for inquiry into the rationale for the high cash position. If, however, a consistently high cash position declines, there may be reason to believe that the fiscal condition of the plan has become more responsible.

In the computation of this index, average monthly expenditures are derived by dividing total yearly expenditures by twelve. The result yielded is then divided by the amount of cash on hand and in banks (demand deposits) as reported on the D-2 form.

Exhibits 16 and 17 graph over time cash and demand deposits as a percentage of average

EXHIBIT 15.—Welfare Plans  
Administrative Costs  
No. of Participants



monthly expenditures for both welfare and pension plans. Exhibit 16, which graphs this index for welfare plans, suggests that the following welfare plans have reasonable financial practices as seen in asset utilization: W-1, W-4, W-6, W-2, and W-8. Although some of these plans have shown cash positions as high as 220 percent of average monthly expenditures, these high levels were not maintained.

Two welfare plans deviate significantly from this pattern. In the eight years for which data is available, welfare plan W-5 has regularly maintained cash balances in excess of 400 percent of average monthly expenditures, most years above 600 percent, and one year at 913 percent.

Welfare plan W-9 registered a cash position which was quite acceptable for the years 1967-1968. In 1965 and 1966, the cash position was, respectively, 380 percent and 640 percent. This would suggest a return to questionable practice.

Generally speaking, the pension plans, as shown in Exhibit 17, maintain relatively low

EXHIBIT 16.—Welfare Plans  
Cash on Hand and Demand Deposits  
Average Monthly Expenditures

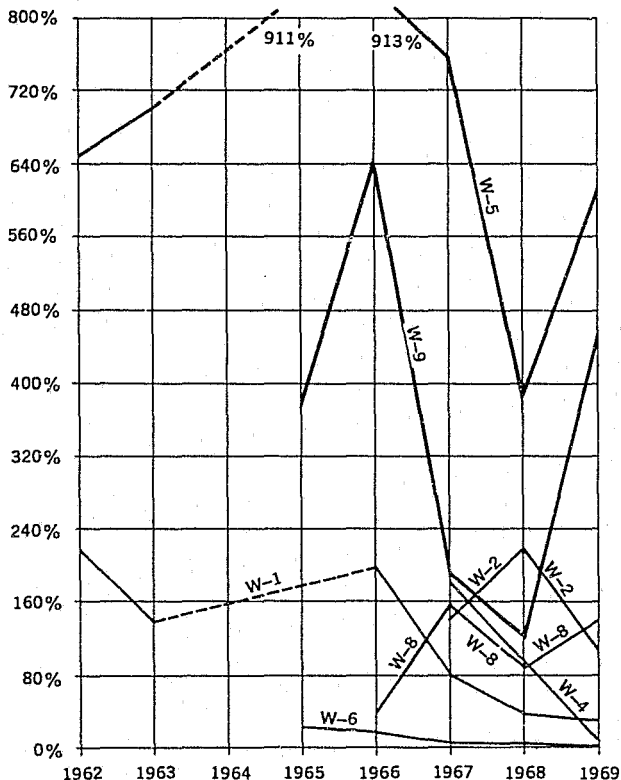
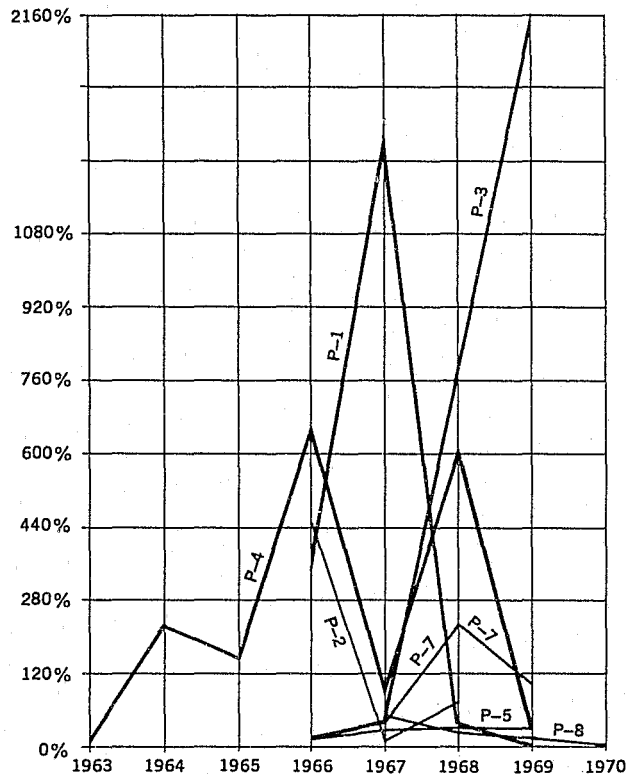


EXHIBIT 17.—Pension Plans  
Cash on Hand and Demand Deposits  
Average Monthly Expenditures



cash positions with respect to average monthly expenditures. As their expenses are more constant and predictable than those of welfare plans, the lower position is not unexpected. However, there are three pension funds which register abnormally high levels: P-3, P-1, and P-4.

The cash position of P-3 rose from a 1966-1968 level of 50 percent of average monthly expenditures to a 1969 level of 2160 percent. This high cash position, however, may be due to the fact that in 1969, P-3 was reorganized into a new fund due to indictments handed down the previous year. It is reasonable to assume that this extraordinarily high cash position represents a temporary position prior to the reinvestment of funds.

Pension plan P-1 showed a rise in cash relative to average monthly expenditures from 355 percent to 1009 percent in 1967. As the 1967 position was followed by a significantly lower 1968 position of 355 percent, it may also indicate a temporary status due to reinvestment. Should, however, the 355 percent position re-

main constant, the possibility of questionable financial practices could be considered.

Pension plan P-4 has shown a marked fluctuation in relative cash position. The graph shows that the cash position has been considerably higher than the 150 percent expected norm. This position indicates possible questionable activities.

While high cash positions cause an unwarranted loss of income through losses of interest, investment in unsecured loans jeopardizes the overall asset position of the fund. Also, unsecured loans may be a means to provide funds to questionable, or even criminal, interests. The unusual nature of these investments is borne out by the fact that only one pension plan and its respective welfare plan have a major portion of assets as unsecured loans.

Welfare plan W-1 had unsecured loans between \$2.3 and \$4.2 million between 1966 and 1969, forming a significant proportion of fund assets. This is shown below:

| Year | % of Invested Assets<br>in Unsecured Loans |
|------|--|
| 1966 | 93.4                                       |
| 1967 | 76.1                                       |
| 1968 | 88.9                                       |
| 1969 | 45.8                                       |

The accompanying pension plan, P-1, had unsecured loans of over \$10 million in 1968 and \$4 million in 1969, forming a significant proportion of plan assets.

| Year | % of Invested Assets<br>in Unsecured Loans |
|------|--|
| 1968 | 98.0                                       |
| 1969 | 34.8                                       |

There is reason to suspect that similar loans had been made in earlier years, but perhaps disguised. This possibility arises out of a discrepancy found in the filed forms. Form D-2 requires that the plan list its current asset position and the asset position as reported at the end of the previous reporting year. The 1967 Form D-2 filed by the pension plan, P-1, listed in 1967 more than \$9 million invested in non-government obligations. However, on the 1968 form in the column in which prior years' assets are to be listed, no entry was made under the heading "non-government obligations." Rather, the \$9 million figure is reported as an unsecured loan. The question therefore arises as to whether or not the entry for all preceding

years showing non-government obligations might, in fact, represent unsecured loans. If so, the unsecured loans have been carried and misrepresented since 1960.

#### *Discrepancies on Financial Reports*

In preparing the financial data for the aggregate analyses discussed above, several discrepancies were found. The first, that concerning the levels of unsecured loans carried by pension plan P-1, has already been noted.

Two other curious discrepancies were discovered. The first concerns the 1967 and 1968 financial statements of welfare fund W-2. In 1967 the cash flow statement shows, after comparing total income and total disbursements, a small surplus of \$1,000. However, the assets for the fund declined by over \$6,000. Therefore, the total amount of unaccounted-for funds was \$7,782. In 1968, the cash flow statement shows an income surplus of \$17,547 while the assets of the fund increased by only \$6,377. Therefore, the total amount of funds unaccounted for was \$11,170. For both years, the fund had all of its assets in savings and loan association shares and bank deposits. Since no sale of assets was recorded, the discrepancies cannot be accounted for by capital losses registered through asset transactions. It seems that an inquiry into the disposition of these "unaccounted-for" funds is therefore warranted. This measure of unaccounted funds may have future development possibilities.

The third discrepancy was found in the 1968 D-2 form filed by the welfare plan W-6. The fund reported an increase of approximately \$1 million in its holdings of federal bonds, an increase which is not accounted for in the listing of "Purchase of Assets." Furthermore, the increase in bond holdings is more than \$200,000 more than the surplus of total income-total disbursements can account for. Therefore, there seems to be a \$232,344 surplus of funds which cannot be accounted for. One possible explanation is that previously depleted assets were replaced so as to rectify the accounts of the fund.

#### **D. Implementation of Methodology**

A major problem in this investigation was to determine which Federal, state, and local laws were being violated in order to allocate investigative responsibility among agencies

with different jurisdictional responsibilities. This problem arises from the fact that it is not necessarily illegal, for example, to spend more money than comes in, maintain large amounts of money in non-interest-paying accounts, or invest in speculative real estate ventures. It is necessary to determine the intent behind the actions which caused these phenomena, and under which jurisdiction these actions may constitute violations of criminal law. For example, analysis of Form D-2, which is required by Federal statute, may identify inflated payments for certain services. This may not be a Federal violation, but it may be a violation of state fraud statutes. This problem is now being examined by the staff of a local prosecutor's office.

Other problems which were confronted, and their solutions, are summarized below:

1. Considerable time had to be spent in becoming acquainted with welfare and pension plan reporting requirements, the locations of files, the methods required to obtain D-2's, and some of the subtleties involved in reporting. This effort would not have to be duplicated, as the general method has been developed.
2. All indices were computed and plotted by hand, requiring considerable time. The historical analysis of indicators could be better prepared with a single computer program.
3. Obtaining knowledge of past organized criminal influence upon plans required

the establishment of the research team's credibility and trustworthiness with a number of law enforcement officials. This sensitive information could be readily obtained by law enforcement officials.

The initial analysis of the nine welfare and pension plans required several man-months. This included obtaining and gaining understanding of the Form D-2's and the computing and plotting of indices. This work was accomplished primarily by research assistants after the forms were obtained; future work could be accomplished by clerks. Relating historical shifts in trends to organized crime and evaluating indices which were developed to measure changes in criminal or irregular behavior required between one and two man-months of senior-level analysts. This, too, would not have to be duplicated as enforcement officials are better aware of past impacts of organized crime upon plans.

Determining how to use this information in investigations and prosecutions required less than one man-month. At this point, research is underway to determine whether local fraud cases can be made. As plans which are suspected of irregular or criminal activity are identified, probably another man-month of conventional investigative work will be required.

In summary, an estimate of the time and personnel category now required to analyze five indicators for 18 plans *without use of a computer* is:

| Project   | Manpower Requirements  |
|---|--|
| Step 1: Obtain D-2's for selected labor unions and outline analysis.  | 1 man-day enforcement official;<br>2 man-day research assistant;<br>1 man-day clerk.                                     |
| Step 2: Compute indices, and plot historical data.  | 3 man-days research assistant;<br>15 man-days clerk.   |
| Step 3: Obtain data on past influence of organized crime upon labor unions, and relate to shifts in trends.         | 1-5 man-days enforcement official;<br>1-5 man-days research assistant;<br>1-5 man-days clerk.                            |
| Step 4: Select indices for continued analysis.  | 1-2 man-days enforcement official;<br>1-3 man-days research assistant;<br>1-3 man-days clerk.                            |
| Step 5: Allocate investigative personnel based on historical shifts in indicator trends.                            | Unknown.   |
| Step 6: Develop hypotheses for new indicators for future analysis, and annually compute indices, plot, and analyze. | 1-10 man-days enforcement personnel per year; 10-20 man-days research assistant per year; 15-25 man-days clerk per year. |

A system for the analysis of financial indicators of plans can be designed with the allocation of 28-51 man-days and operated with 26-81 man-days per year. It is really not possible to estimate the investigative and prosecutorial requirements. If the data from the D-2's were fed into a computer and a few simple programs written, hundreds of indices for many more than 18 plans could be analyzed in far less time.

This analysis could require even fewer law enforcement resources if businessmen, citizens groups, and leaders of the labor movement were to monitor the financial and business practices of labor unions. The encouragement of this activity would have to be based upon local conditions.

### **E. Monitoring and Self-evaluation**

The examination of D-2's should provide a deterrent to organized criminal activity as new information is being obtained upon which to base investigative and prosecutorial decisions. Pressures resulting from a systematic analysis should at least result in changes of the methods by which organized crime affects labor unions. This can probably be readily monitored by knowledgeable law enforcement officials.

In the examination of historical data and relationships, efforts should be made to determine specifically what events or phenomena occurred which may have caused a trend to shift. In many cases, a shift can be attributed to perfectly legitimate events such as a strike, which

may deplete a strike fund, or participation in a new insurance plan, which may raise administrative costs. Other shifts may be attributable to changes in the scope and incidence of criminal activities. These changes can result from law enforcement activities, such as investigations and prosecutions, or agreements among criminal interests, such as negotiation of sweetheart contracts or purchase of unneeded services. These and other past events should be understood by law enforcement officials. As indicators are plotted from current D-2's, shifts which are similar to historical shifts should be studied to see whether they signal a repeat of the event which occurred in the past or possibly a new event linked to organized criminal or legitimate activities. This process of identifying relationships between indicator trends and events, particularly those which have occurred in the past, is important as it aids in the identification of the forces which affect the degree to which labor unions are influenced by organized crime.

Self-evaluation and monitoring requires the continued examination of new indicators, making appropriate investigations into the reasons for the shifts. These investigations, whether an audit of a union's books or surveillance of new union officials, should not focus only upon labor racketeering as defined by Federal statutes, but should also consider violations of state and local criminal laws. Monitoring and self-evaluation, then, should focus on the relationships between indicator trends and events.

## IX. CONCLUSIONS AND ALTERNATIVE APPLICATIONS OF INDICATORS OF ORGANIZED CRIME

The research and analyses which comprised this project were conducted, in part, with the cooperation of an ongoing law enforcement effort, the Wayne County (Michigan) Organized Crime Task Force. This approach was judged by Law Enforcement Assistance Administration officials, officials of the Task Force, and project staff as a way to determine quickly the utility of new analytical techniques in local law enforcement. Inasmuch as these techniques have been tested in a local law enforcement effort and are now being used to identify investigative leads and obtain evidence for grand jury proceedings and trial, law enforcement officials and those generally concerned with the development of effective law enforcement programs should be able to apply quickly this form of analysis to local enforcement efforts.

In order to estimate efficiently the potential utility of such analyses, it is necessary to recognize the many jurisdictional differences and responsibilities of the various Federal, state, and local law enforcement agencies. It will not be possible to recommend a single "best" set of indices and analytical procedures. It is also necessary to consider more than jurisdictional differences among agencies; differences among the various policy-making and managerial procedures such as planning, resource mobilization and allocation, operations, and evaluation must also be recognized. As this general form of analysis proves to be valuable in law enforcement, each application of these analytical techniques and the use of the data by various law enforcement agencies may be different.

A long-term commitment to the development of indicators of organized crime of the type described above could lead quickly to the development of indicators which *measure directly* changes in the incidence and scope of organized crime. The above indicators were hypothesized to reflect or monitor indirectly changes in organized criminal activity. As these indicators are further developed and their relationships with organized crime are better understood, it

may be possible to conduct analyses which focus more directly upon organized criminal activity. Examples of this might include: determining the actual amounts of loan shark loans to industrial workers and the reasons for these loans as check-cashing patterns become better known, identifying the number of workers on sweetheart contracts as it relates to employer payments to pension plans, and identifying the number of gamblers as the sale of gambling publications becomes better known. One reason it may be possible to identify quickly indicators which describe organized crime in direct terms is that local enforcement officials are always involved in the interpretation of shifts in patterns of the indicators described above. Through other forms of analysis, based largely upon conventional police intelligence operations, data which describe directly organized criminal activity could be acquired and analyzed.

Indicators of organized crime have uses outside of direct law enforcement efforts. They can be used by businessmen to obtain insight into attempts by organized crime to influence their businesses, such as by placing loan sharks in plants or infiltrating a labor union. Labor officials can obtain information pertinent to attempts at labor racketeering. Other community interests—civic organizations, schools, and so on—would be able to conduct many of the above analyses and use the information to influence community-based change.

The analyses undertaken suggest that indicators which monitor changes in organized crime can be developed. One advantage to this general analytical form is that these indicators can be quickly postulated, developed and tested, and, if valid, put into an operational context without disrupting ongoing programs. The use of such indicators should be quite inexpensive. Once one is postulated, investigative and law enforcement personnel are not required for computation. Also, the process of collecting and

analyzing data can be unobtrusive, thereby not alerting criminal or questionable interests as to what activities are being monitored.

The use of indicators similar to those discussed above could provide a new dimension to

organized crime control programs. The ultimate effectiveness, however, of this form of analysis can only be determined through further testing of these techniques in the context of specific law enforcement programs.