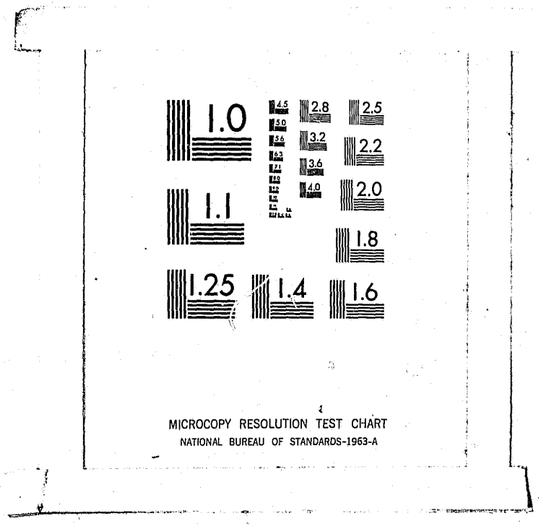




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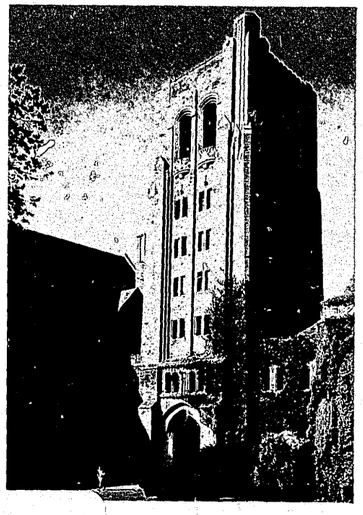

# The Investigation and Prosecution of Organized Crime and Fraud

# Fraud: Background Materials



GERARD V. BRADLEY • SOL MARTIN ISRAEL • JOHN L. SANDER

Cornell Institute Organized Crime

1980 Summer Seminar Program

# The Investigation and Prosecution of Organized Crime and Fraud



FRAUD

BACKGROUND MATERIALS

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"No matter how supple the rule
the rush of life is always swifter"[1]

## I.

## WHITE COLLAR CRIME, ORGANIZED CRIME, AND FRAUD

Question: What do Spiro Agnew,[2] Joe Valachi,[3] and a healthy, ever-growing percentage of all automobile repairmen[4] in the United States have in common? Answer: They are all white-collar criminals, and their otherwise varied biographies buttress FBI Director William Webster's caution that "there is no such thing as white-collar crime as a term of art. It...is a cluster of criminal activities, which distinguishes it from other types of activities."[5]

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[1] J. Goebel, Felony and Misdemeanor, xxxvii (1937)

[2] See text accompanying notes 47-49, infra.

[3] By his own account, Valachi trafficked in counterfeit ration coupons during World War II. See P. Maas, The Valachi Papers (1969)

[4] From 1971 to 1974, U.S. Department of Health, Education, and Welfare's Office of Consumer Affairs reported that auto repairs ranked number one of all consumer complaints recorded by state, county and local consumer protection offices. The list of abuses is long and varied. Carowners frequently reported paying for unnecessary repairs or replacement of parts, or being charged for services not performed. Other consumers told of unknowingly buying used parts for new parts, accepting fraudulent guarantees or discounts, or simply paying for incompetent work.
A large number of complaints also involved corrupt mechanics who tried to unfairly raise estimates after repairs were underway. Under these schemes, customers refusing the more expensive work were still required to pay the original estimate merely to have their cars reassembled. National Conference of State Legislatures, The States Combat White-Collar Crime, 20-21 (1976)

[5] W. Webster, "The FBI and White Collar Crime Today." 50 N.Y.S.B.J. 635,636 (1978)

The distinction lies in the means of perpetration. The Justice Department's working definition of white-collar crime for 1980 is "those classes of non-violent illegal activities which principally involve traditional notions of deceit, deception, concealment, manipulation, breach of trust, subterfuge or illegal circumvention."[6] The "cluster" is thus an agglomeration of discreet "economic" crimes and corruption offenses. The former represent the great bulk of white collar criminal activity and include false advertising, embezzlement, securities theft, restraints of trade, and an ever-burgeoning array of frauds. Corruption is principally "public", or breaches of trust by government employees, but also includes commercial bribery and abuses of other fiduciary relationships.[7]

Because concealment is so woven into the pattern of these offenses, the "cost" of white collar crime is but vaguely perceived. The United States Chamber of Commerce calculated the gross take of white collar offenders at "certainly not less" than 40 billion dollars annually.[8]

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[6]P. Heyman, "Introduction to White Collar Crime Symposium," 17 Am. Crim. L. Rev. 271, n.1 (1980)

[7]Definitions, or descriptions, of "white-collar crime" are legion. See e.g. E. Sutherland, White-Collar Crime, 9 (1949); H. Edelhertz, The Nature, Impact and Prosecution of White-Collar Crime, 3 (1970); National Conference of State Legislatures, The States Combat White Collar Crime, 5 (1975) The list presented in the text is not gospel - but it is appropriate for purposes of this paper.

[8]Chamber of Commerce of the United States, Handbook on White Collar Crime, 5 (1974)



But this six-year old "ball-park" measure of direct, short-term loss encompassed neither illegal price-fixing nor industrial espionage. The total current loss is probably much higher. At the individual enterprise level, reliable figures drawn from prosecuted cases reveal an ungodly profit margin. One mob-run arson racket, operating between 1969 and 1975, pulled down approximately $500 million.[9]

Dollars are not the only cost of white collar crime, only the most obvious one. Other costs are the number and kind of people victimized. While institutions like government are frequently the targets of bigger rip-offs, the typical consumer fraud counts its victims by the hundred, if not by the thousand, and gathers them from the middle and lower classes. Hence the financial loss and personal demoralization attending victimization are visited upon those who can least afford them. The Rio Rancho real estate fraud, for instance, involved the sale of 77,000 separate parcels of New Mexico desert, almost wholly to individual purchasers whose lot represented a parcel of the future.[10]

More important is the demoralization of society which white-collar crime portends. Dishonest practices retard economic growth by debasing competition.[11] Where one

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[9]C. Karchmer, "Arson and The Mob," 2 Firehouse 22 (August 1977) [hereinafter Karchmer].

[10]See text accompanying note 22, infra.

[11]Handbook, supra note 8, at 7.

firm is willing to compete illegally or pay-off government officials, others in the same market are obliged either to follow suit or face eventual failure and bankruptcy. The actual result in many cases is the departure of reputable firms from the infected market. In addition, as the public loses confidence in the private sector's ability to police itself, consumer "backlash" looms. Case in point: an investigative task force reported that one cause of the Watts riot in 1965 was "retribution on merchants who were guilty of consumer exploitation".[12]

This effect of snowballing illegality is especially pronounced when organized crime[13] gets into the act. Securities theft, arson fraud, "bust-out" or bankruptcy fraud, sophisticated looting of labor unions and businesses within its control, illegal operation of "legitimate" businesses, and official corruption have long complemented such mob staples as gambling and narcotics. The "organized"

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[12] Id.

[13] A single, standard definition of "organized crime" (or "white-collar crime" for that matter) is neither necessary nor wise. The terms have evolved in response to a growing realization that the conduct and offender groups so designated presented a greater threat to society than that contained in common crimes.
A definition of either need only be adequate for purposes of analysis. The terms might be used for such varying purposes as allocation of jurisdictional authority or investigative and prosecutoral resources, determining availability of a special legal or investigative tool (wiretaps, subpeonas, grand juries), and classifying prisoners. For a discussion of some uses of term "organized crime", see G. Blakey, R. Goldstock, Techniques in the Investigation and Prosecution of Organized Crime: Manuals of Law and Procedure, ¶4-10 (1978).



white collar criminal, drawing upon huge reserves of capital, enjoying access to a vast network of criminal operatives and ongoing schemes, and with compromised politicians and police in his camp, benefits from economies of scale in each of his rackets.

The bottom line of the bill presented by white-collar criminals is this: widespread flouting of legal constraints by "respectable" people - businessmen, politicians, lawyers - erodes the moral base of law. When those who, as a class, produce law treat it in practice as merely an obstacle to their enrichment, what can law be but the instrument of ruling class greed? To the extent this perception permeates society, the voluntary consensus upon which society's institutions rest is jeopardized.

Fraud is a choice case study in organized and white collar crime not only because its definition - conduct, less than forthright, intended to deprive another of money, property or a legal right without the use of force[14] - tracks that of white-collar crime so closely, but also because fraud offenses constitute a hefty proportion of all white-collar crime. The chief advantage of studying fraud, though, is that it perfectly illustrates the remaining aspect of the problem: fraud, like white-collar crime generally, is highly resistant to investigation and prosecution. Part of the reason of course is that a salient

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[14] Again, this need not be a term of art, but merely a working definition.

feature of these crimes is concealment of all evidence indicating that a crime has been committed. But the key is a congeries of impediments to effective deterrence, most prominently a criminal justice system which has developed historically in response to predatory crimes. Robert Peel's parliamentary argument for instituting a modern professional police force fully applies. Quite simply, "the art of crime...has increased faster than the art of detection,"[15] and the issue is whether law enforcement has the legal tools, concepts, and imagination to make a race of it again.

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[15] Quoted in T. Critchley, A History of Police in England and Wales 900-1966, 53 (1967).



## II.

## FRAUD: DIMENSIONS OF THE PROBLEM

### A. Overview

Fraud is a dynamic, multi-faceted reality. It is democratic.[16] Frauds are committed by destitute beneficiaries of welfare programs who conceal income to qualify for benefits; by civil servants who demand gifts and kickbacks from government contractors; and by high level public officials who have complex conflicts of interest or who demand political contributions for special treatment.

Frauds are perpetrated by single individuals falsifying invoices for government reimbursement, manipulating businesses, or working a simple confidence game like the pigeon drop. Frauds are perpetrated, as well, by conspiracies and organized crime rings. Government benefit programs are systematically looted by procuring payment for services never rendered or goods never supplied; entire industries - like insurance - are defrauded by demanding payment for phony accidents or intentionally set fires.

The schemes may be simple, age-old ones committed quickly during a single perpetrator/victim encounter, the case in most bunco schemes and confidence games,[17]

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[16] H. Edelhertz, supra note 7, at 4.

[17] See, e.g., Confidence Games and Swindles, 23 Am. Jur. P.O.F. 1 (1959-61).

or very complex ones with no direct offender-victim contract (because the victim is an institution) perpetrated over time by the manipulator of government or business records, the case in many modern computer embezzlements.[18]

The amounts defrauded may be small, such as the few dollars gained by the welfare recipient misrepresenting the number of his dependents, or they may be enormous, the case in major investment swindles, such as the Equity Funding rip-off, involving an estimated loss of $2 billion.[19]

Bureaucracies - private and public - are the primary victims of fraud.[20] They are logical targets given the resources under their control, their unpopularity, the low visibility of fraud, the rationalizations available to offenders, and the nature of the bureaucratic response to victimization.[21]

The real victim, however, is the public, which bears the burden by paying higher taxes and increased costs of goods and services. The impact of fraud falls on individuals, and on their physical and psychological integrity and security. That impact is not very different from the impact of "common" crime, except that the effects of fraud are longer lasting.[22]

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[18] See, e.g., D. Moffit, ed., Swindled: Classic Business Frauds of the Seventies (1976); W. Porter, "Computer Raped by Telephone," N.Y. Times Magazine September 8, 1974, at 40; D. Parker, Crime by Computer (1976).

[19] See J. Conklin, Illegal but Not Criminal, 4 (1977).

[20] See, e.g., E. Smigel, Crimes Against Bureaucracies (1970); D. Cressey, Other People's Money (1973).

[21] E. Smigel, supra note 20, at 9.

[22] H. Edelhertz, supra note 7, at 9.



The classification of frauds used herein - fraud against the government, fraud against business, fraud against individuals - is considerably more tidy than the reality. Fraud against the government, for example, is also fraud against individual taxpayers. Fraud against business may also be fraud against the government and individuals where, for instance, the torching of government insured property causes the government to pay out to the policy holder. Individual citizens must then endure higher taxes and higher fire insurance premiums. Nevertheless, the distinctions are indispensable for discussion purposes, and do minimum disservice to the facts they represent.

B. Fraud Against the Government

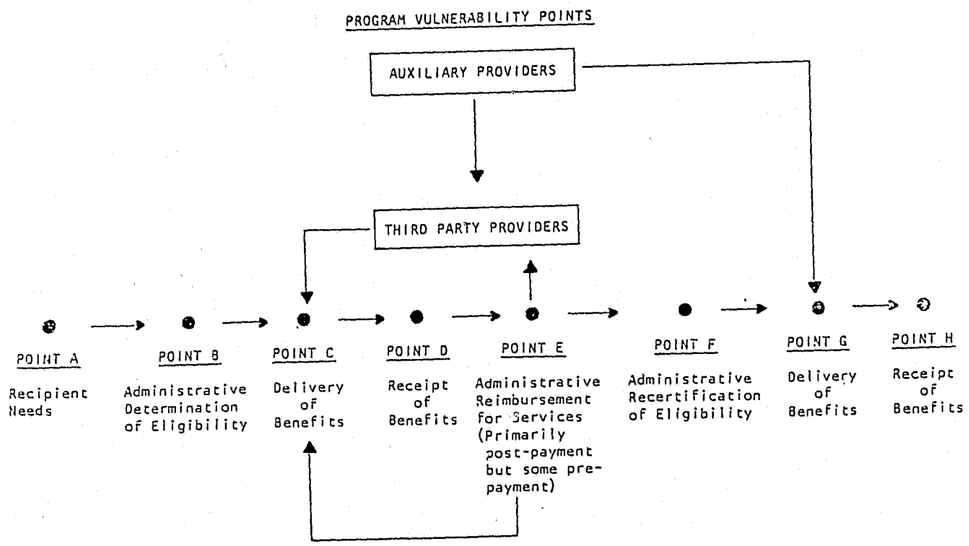
Local, state and federal governments collect revenues, contract for goods and services, and distribute funds through various benefit programs. Governments can be defrauded while performing any of these functions. The focus of this section is fraud in benefit programs and government contracts at the federal level.

1. Benefit Program Fraud

In a G.A.O. report published in late 1978, the Comptroller General stated that opportunities for defrauding the government were virtually unlimited because of the number, variety, and value of federal programs. These programs, involving innumerable recipients, providers of goods and services, and public employees entrusted with administration, account for more than half of all federal outlays. The G.A.O. reported expenditures of $250 billion annually in economic assistance programs, and that the Justice

Department estimated the incidence of fraud at 1-10 percent, resulting in 2.5 to 25 billion dollars of fraud in government programs, exclusive of tax fraud.[23]

These programs are susceptible to fraud by four classes of people: 1) recipients, those persons who directly receive the benefits; 2) administrators of the programs; 3) third-party providers; and 4) auxiliary providers, those persons responsible for providing the benefits directly to the recipients, or to third party providers and administrators. Offenses may be committed by individuals in any of the above classes, acting alone or assisted by individuals in other classes. Programs are vulnerable to fraud at many transactional points. The flow diagram[24] below helps conceptualize these opportunities.




[23] Federal Agencies Can and Should Do More to Combat Fraud in Government Programs: Report of the Comptroller General (1978) [hereinafter G.A.O. Report].

[24] A. Lange, Fraud and Abuse in Government Benefit Programs, 19 (1979) [hereinafter Benefit Programs] Government studies distinguish fraud from abuse. Abuse is the improper utilization of a



Recipient offenses fall into four basic categories. The first is misrepresentation of information to qualify for initial benefits where legitimate qualification would be impossible, or to secure benefits beyond recipient's legitimate entitlement. Second is creation of "ghost" eligibles to receive duplicative assistance; third, intentional misreporting or failure to report relevant changes of eligibility status; finally, improper use of benefits.[25] Since most of these offenses are unsystematic, low level abuses, they should be handled by internal organizational and audit controls and procedures, unless evidence of a conspiracy with program administrators or providers comes to light.

Third party provider and administrator offenses require heightened law enforcement attention because the amounts involved are significantly greater than in recipient offenses. The offenses are also probably chronic and better concealed, the perpetrators may be among those charged with internal audit

(24 cont'd)

benefit or benefit system and rests on an official determination of impropriety. When the impropriety is proscribed by law and criminal intent can be shown, abuse is fraud. Often benefits are obtained or used in ways not contemplated by the law but which are not specifically prohibited by law or regulation. Program abuse includes practices as diverse as making administrative errors on eligibility forms to the irregular and inadequate provision of quality-of-life care for nursing home residents. Abuse also entails the improper interpretation of policies and program guidelines and taking advantage of ambiguous policies. For this reason most enforcement officials perceive abuse as far more damaging to program integrity than fraud. No accurate estimates of abuse in government programs have been ventured to date. Id. at 16.

[25] Id. at 20-23.

and control, and, in addition, may be members of conspiracies or organized crime groups.[26] Perhaps most important, administrative personnel are uniquely situated to defraud the government because of their familiarity with program operations -- they are often intimately familiar with the agency's anti-fraud strategy and its weaknesses.

The schemes perpetrated by administrative personnel acting without collusion of recipients or providers are limited to the creation of ghosts. A computer technician responsible for payment of health claims to providers, for example, may manipulate the program to create a ghost provider and ghost patients and then embezzle the payments.[27] Administrative personnel acting in collusion with providers are a threat of a different order: they defraud taxpayers but also undermine the very integrity of their programs. An administrator's approval for payment of a false claim injures the taxpayer; the same administrator's failure or refusal to monitor provider performance injures those needy recipients who require the faithful service of government employees.[28]

There is only slight evidence so far of organized crime involvement in benefit program fraud.[29] According to a recent study of fifteen government benefit programs,

[26] Id. at 23-35.

[27] Benefit Programs, supra note 24, at 35.

[28] Id.

[29] See Fraud and Racketeering in Medicare and Medicaid: Hearing Before the Select Committee on Aging, U.S. House of Representatives [Ninety-Fifth Congress Second Session], October 4, 1978.



only two percent of the respondents suspected organized crime involvement. Organized crime elements allegedly used such techniques as black market trafficking, counterfeiting, and forgery to accomplish benefit-related crimes.[30]

The following table [31] summarizes the potential offenses and offenders in government benefit programs.

TAXONOMY OF OFFENDERS AND OFFENSES

| | RECIPIENTS | SPONSOR AGENCY | THIRD PARTY PROVIDERS | AUXILIARY PROVIDERS |
|---|---|---|---|---|
| MISREPRESENTING ELIGIBILITY | ● | ● | ● | |
| CREATING "GHOST" ELIGIBLES | ● | ● | ● | |
| IMPROPERLY USING BENEFITS | ● | | | |
| RECEIVING ADDITIONAL BENEFITS | ● | | ● | ● |
| OVERCHARGING FOR SERVICES | | | ● | ● |
| WITHHOLDING SERVICES | | ● | ● | ● |
| OFFERING UNNEEDED SERVICES | | | ● | |
| ACCEPTING OR PAYING KICKBACKS | | ● | ● | ● |
| TAMPERING WITH RECORDS | ● | | ● | |
| EMBEZZLING OR STEALING BENEFITS | | ● | | |
| OVERPAYING OR UNDERPAYING BENEFITS | | ● | | |
| COUNTERFEITING BENEFITS | ● | ● | | |
| ILLEGALLY OWNING BENEFIT SERVICES | | | ● | |

(29 cont'd)

The appendix includes "The Corrupt and Fraudulent Practices Resulting from the Factoring of Medicaid Bills," a November 4,1968 grand jury report, New York County, N.Y., and a collection of articles reprinted from newspapers, magazines, and other hearings reporting organized crime involvement. Organized crime involvement was reported in the ownership of nursing homes, prepaid health plans, pharmacies, clinical laboratories, supply houses, computer firms, factoring companies, and hospitals.

[30] Benefit Programs, supra note 24, at 18.

[31] Id. at 40.

## 2. Case Study of Provider Fraud: The Nursing Home Industry

Nursing home revenue rose dramatically from $500 million in 1960 to $14 billion in 1978.[32] The government provides more than half of this income; private pay residents, constituting 30 percent of the nursing home population, account for the other half.[33] Note that the status of private residency is fluid: the Congressional Budget Office estimated that 47.5 percent of Medicaid nursing home residents were admitted as private pay.[34] With average monthly charges of $1,000 it is no wonder that most elderly residents quickly exhaust their financial resources.[35]

The characteristics of the market, the victims, and the government reimbursement system promote fraud and poor health care. The most serious frauds and abuses involve the manipulation of costs to inflate vouchers for government reimbursement.[36] The following extract from an F.T.C. policy briefing[37] illustrates three of the more complex methods used to manipulate costs to receive unjust reimbursement.

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[32] See E. Taylor, "Policy Implications of Long Term Care for the Elderly" (App. A in an F.T.C. policy briefing on health issues to be published in the future), 116.

[33] Id. at 118.

[34] Congressional Budget Office, Long Term Care for the Elderly and Disabled, 24 (1977).

[35] Taylor, supra note 32, at 118.

[36] See Kickbacks Among Medicaid Providers: Hearings Before the Senate Special Committee on Aging, 95th Cong., 1st Sess. (Comm. Print 1977).

[37] See Taylor, supra note 32.



### A. Real Estate Transactions

The nursing home business appears to be a lucrative market for real estate speculators. Those who buy, sell, or lease nursing homes are reimbursed for all their transaction costs by state and federal government as long as they participate in the Medicaid and Medicare programs. Allowable costs include lease or mortgage fees, depreciation, interest rates, excise taxes, and insurance--all calculated anew each time a facility is sold or leased. Incentives exist for both buyers and sellers to enter into sales transactions at higher than market prices: purchasers can get higher Medicaid or Medicare payments and the capital gains tax benefits the seller. Reports of such activities have come from Washington, Maryland, New York, Missouri, Montana, Ohio, Nebraska, Texas, and California. They involve some of the largest nursing home chains, as well as the smallest facilities.

### B. Service and Management Contracts

Nursing homes with high operating expenses receive larger Medicaid and Medicare payments. As a result, one finds nursing homes that have contracted with related or sympathetic vendors for various goods and services at higher than market prices. Such items include: housekeeping, computer or management services; insurance; medical equipment; hospital furniture; building construction; and food distribution. Because these goods are included as part of a nursing home's daily costs, they are difficult to detect; nonetheless, they add significantly to the basic cost of care.

An increasingly common example of "making profit off cost" is for a nursing home to enter into a management agreement with itself or another company. The management company is reimbursed for a reasonable profit, while its fees are treated as costs to the facility and are also reimbursed. Some management contracts are doubtlessly genuine, improving care and saving money for residents and taxpayers alike. Nonetheless, it is difficult not to be skeptical about the motives behind many such multiple-layered operations, under the current reimbursement system.

Another, more subtle form of increasing nursing home costs is for a company to build its own facility, charging more for its construction than is necessary or justified. Because it is very difficult for state auditors to prove inflated construction costs,

this is a relatively easy and safe way to manipulate higher reimbursement levels. As one authority has stated,

> Preopening profit possibilities abound in arrangements which produce a profit on land, construction, financing and consulting. The end result is that the owner is selling these items or services to himself. The profits made go both into the pocket and as equity for the project. Through these mechanisms, a knowledgeable operator can produce a facility with virtually one hundred percent financing and a considerable amount of in-pocket cash prior to opening. All of such profit is, of course, in the form of increased debt for the facility which is then repaid over the years through cost reimbursement. Anyone who thinks that this is not being done is naive.
>
> (Markham, Cost Reimbursement - The Basic Program, Nursing Homes, July/August 1977 at 8.)

C. Ancillary Goods and Services

A third means of manipulating expenses can occur when a nursing home arranges with outside retailers to supply its residents with ancillary goods and services that are not part of its daily fee. The most common items are prescription and non-prescription drugs, therapy, laboratory work, and various medical supplies, such as wheelchairs and crutches. Inasmuch as residents are seldom able to shop for these goods themselves, they are the epitome of a captive audience, routinely relying on the nursing home's choice of drug stores, laboratories, wheelchair suppliers and therapists for their needs. The situation is ripe for exploitation.

Unfortunately, nursing homes do not always have an incentive to select ancillary providers with the lowest prices. On the contrary, since reimbursement for such goods comes directly from the private resident or the government, certain schemes involving high-priced vendors can actually benefit operators. Kickbacks are the most obvious of these, there, in order to get a nursing home's business, a retailer must kick-in a little extra for the administrator. This "little extra" is then passed on to residents in the form of higher prices. A second and perhaps more lucrative way to increase profits is through related-party transactions, where a nursing home owns the company that sells the ancillary goods and services to its residents. Indeed, instances of self-dealing are becoming increasingly common



> among nursing home providers. It has been reported that after one nursing home chain purchased its own pharmacy, its drug prices went up 40 percent.
>
> In the nursing home industry, normal market forces such as a mobile and alert consumer, a free flow of information, and ample competition are weak. Self-dealing may be a means of deceiving consumers about the market prices for ancillary goods and services. It may also inflate nursing home costs generally and may serve to circumvent Medicaid reimbursement regulations.

All of the above abuses or frauds have been documented by the State of New York Special Prosecutor for Nursing Homes, Health and Social Service since its creation in 1975.[38] Four years of investigation revealed that New York's profit-making nursing home operators submitted over $63 million worth of inflated claims for Medicaid reimbursement between 1969 and 1975, costing the taxpayers of New York $42.6 million (approximately five cents of every Medicaid nursing home dollar subsidized fraud). Of this amount, $31.2 million is being recovered through court actions ($7 million has already been returned); the remainder will be sought after investigations are completed.[39]

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[38] See Analysis of New York's Profit-Making Long-Term Care Facilities (1978) [hereinafter Analysis] for typical schemes used by nursing home operators, including personal luxury fraud, kickbacks, and pyramid schemes related to sales and lease arrangements. See also Willow Point, Special Report by Charles J. Hynes Deputy Attorney General for Nursing Homes, Health and Social Services (March 20, 1978) for a report of the year long investigation of the Willow Point Nursing Home and Health Related Facility, involving the construction and sale of the facilities to the public at a profit to the entrepeneurs of $3 million on a $100,000 investment.

[39] Fourth Annual Report of the Deputy Attorney General for Nursing Homes, Health and Social Services in N.Y. State, 7 (1978).

Recovery has been accomplished by restitution in criminal cases as part of a negotiated plea, and by independent civil actions where the provider received $25,000 or more in Medicaid overpayments.[40] Criminal restitution to date is responsible for recovery of $6.2 million of the total $7.25 million.[41] The money has been placed in an interest bearing account for eventual distribution to the appropriate various federal, state, and local governments.[42]

The challenge for nursing home investigators, auditors, and attorneys is in unmasking the financial interests in the homes so that reimbursable costs can be analyzed. Then, where self-dealing, conflicts of interest, kickbacks, and other pyramid schemes are exposed, those responsible must be prosecuted and the illegal gain recovered. This strategy, coupled with the imposition of administrative sanctions such as termination of a provider's certification, can be effective in controlling and deterring such schemes.

3. Fraud in Government Contracts

The potential for fraud and abuse in government contracting, as in benefit programs, is substantial. Federal procurements for fiscal year 1977 were about $80 billion including G.S.A. procurements for supplies and services and D.O.D. procurement of major weapon systems.[43] The Justice Department's estimate suggests fraud approximating 1 - 10 billion dollars.

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[40] Analysis, supra note 38, at 23-25.

[41] Id. at 28.

[42] Id.

[43] See, "Preventing Fraud and Error and Increasing Public Confidence In Federal Programs - Top Priorities," remarks of Comptroller General of U.S. [reprinted in The Secretary's National Conference on Fraud, Abuse and Error] (December 13, 1978) at 14.



The pervasiveness of fraud in government contracting can be attributed to: federal procurement policies; antiquated design specifications which discourage competition; the failure to limit noncompetitive procurement and to assure proper monitoring of contract performance; and favoritism, conflicts of interest, and other types of subjectivity in the award of grants and contracts.[44]

4. Case Study: The G.S.A. Self-Service Stores

Allegations of widespread corruption in the General Service Administration surfaced early in 1978 and soon blossomed into a major scandal attracting national news coverage.[45] On September 18, 1978, then-Deputy Attorney General Benjamin Civiletti created a special G.S.A. Task Force within the Justice Department. The G.S.A. self-service stores in Region 3, covering the District of Columbia, Virginia, Maryland, Pennsylvania, Delaware, and West Virginia, were principal targets of the inquiry.[46]

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[44] Id. at 163.

[45] See generally G.S.A. Contract Fraud Investigation: Hearings Before the Subcommittee on Federal Spending Practices and Open Government of the Committee on Governmental Affairs, United States Senate (Ninety-Fifth Congress, Second Session), June 22,23; September 18,19, 1978.

[46] For the most recent summary of the status of the G.S.A. investigation and cases under prosecution see Statement of William Lynch, General Service Administration Investigations: Hearings Before the Subcommittee on Federal Spending Practices and Open Government of the Committee on Governmental Affairs, United States Senate, January 29, 1980. This narrative is composed primarily of material contained in a memorandum prepared by Daniel Clemens, Assistant U.S. Attorney for the District of Maryland, December 10, 1979.

The G.S.A. operates approximately 75 self service stores in various regions around the country. The primary purpose of the stores is to supply federal agencies with administrative goods and industrial supplies. The stores receive goods either from G.S.A.'s central depot or on the open market from vendors licensed to do business with G.S.A. There are two methods of procurement from private sources. In a "goose" contract the vendor enjoys the exclusive right to sell a certain item to the government at a preset price. Or, vendors may be party to a blanket purchase agreement -- a "B.P.A." -- which allows him to bid for G.S.A. store supply contracts. Thus if the U.S. Attorney's office requires legal pads (and the central depot is out of them), the store manager calls B.P.A. holders for prices on immediate delivery to the store. The manager must accept the lowest price quoted. Then the low bidder delivers the goods to the store where an individual from the U.S. Attorney's Office picks them up. The G.S.A. charges the Department of Justice's account.

In early June of 1977 the G.S.A. Office of Investigation received an anonymous telephone call alleging improprieties at store #17 in Baltimore. A task force of auditors was dispatched to the store. After questioning, the store manager confessed that he provided tires for personal use to military employees at Fort Meade, who signed false invoices for official army purchases.

Ordinarily a vendor has a B.P.A. with only the store in his immediate vicinity. Further investigation revealed, however, that several companies doing business with store



#17 held B.P.A.'s with numerous self service stores. On that basis the investigation was expanded to all 30 stores in Region 3. In early September of 1977 the first eight grand jury subpoenas, seeking records of all dealings with the G.S.A. stores, were issued to the companies under suspicion.

The original subpoenas were issued by a regular grand jury sitting in Baltimore. After examining the documents returned on the subpoenas, G.S.A. investigators determined that a special grand jury was necessary. The court convened a special grand jury in January of 1978, and all previously obtained documents were transferred to it. This grand jury issued over 250 subpoenas, thereby securing some 200,000 separate documents.

The company records showed sales to the G.S.A. stores far beyond the supply of goods purchased by the companies from manufacturers and wholesalers. One firm, James Hilles Associates, billed the federal government for over 4.4 million hanging folders when its records showed the purchase of only 1 million folders. This discrepancy accounted for false billings of $630,000.

The agents did an analysis of company purchase records. They found an assortment of items not normally purchased in the suspects' line of business which could not have been properly resold to the government. The total false billings for Hilles alone was $1,300,000, representing the cost of carpeting, trips, televisions, guns, and other items given to government employees for abetting the fraud invoices.

After completing the document review, teams of one G.S.A. agent and one F.B.I. agent interviewed targeted

individuals in the G.S.A.; in all, about 150 employees. The interviews began with an advice of rights, an explanation of the subject matter of the interview, and a request for voluntary statements. In most cases the target refused to speak until confronted with documents showing false invoices to his store and his receipt of goods for personal use. Approximately 50% to 55% of the individuals confessed when so confronted.

The interviews flushed out some remarkably simple schemes. The Hilles Co. even found a way to pass the cost of their bribes along to the government and make a profit of 30% in the process. If a store manager wanted a pool table costing $1000, for instance, he went to a retail store designated by Hilles and charged it to Hilles' account. When Hilles received the retailer's bill it prepared false invoices showing goods and services worth $1300, not $1000, delivered to the self-service store. In fact, none had been delivered. The store manager then forwarded the false bill to the G.S.A. for payment.

Initial audits failed to detect irregularities because the stores were operated on a cash inventory basis (rather than an item inventory basis), so a store manager had only to show sales equal to purchases. Managers therefore developed two means of passing through false invoices without alerting auditors. Sometimes they over-charged their legitimate customers a small amount, eventually balancing their cash inventory account. The second method required the corruption of



store customers within the federal establishment. In return for bribes, government employees overcharged the G.S.A. for items purchased at the self-service stores. Thus a store manager might take in $1,000 for legal pads costing him $800.

As a result of the interviews, many targets retained counsel and plea bargaining followed. Prosecutors established ranges of recommended sentences depending on the level of the accused's involvement in the scandal. This was a non-negotiable point during the plea discussions. Included within the plea bargaining process was a substantial amount of pre-indictment discovery. This extraordinary route was taken because government attorneys made no attempt to convince targets that the cases against them were airtight. Prosecutors simply presented the facts and an opportunity to plead. The gamble paid off. Of the 48 individuals indicted, 42 pleaded guilty to felonies. Of the six defendants tried, 5 were found guilty. Most were charged with conspiracy to defraud the U.S. in violation of 18 U.S.C. § 371; the other charges were filing false claims under 18 U.S.C. § 287 and bribery under 18 U.S.C. § 201.

As a result of the investigation the G.S.A. redesigned its self-service store procedures, five stores were closed as a result of lack of business, and billings to federal agencies using the stores decreased $25 million annually.

5. Case Study: Spiro T. Agnew[47]

Fraud in government contracting wrought the resignation of then Vice-President of the United States Spiro Agnew. A 1973 investigation by U.S. Attorney for Maryland, George Beall, into political corruption in Baltimore County revealed that Agnew, while county executive, and later as Maryland governor and as Vice-President, received kickbacks on county and state construction contracts. The denouement came on October 10 of that year when, after extensive plea negotiation, Agnew pleaded nolo contendre to one charge of tax evasion, admitting receipt of payments in 1967 not used for political purposes, which he knew were taxable. District Judge Hoffman imposed a three-year suspended sentence and a fine of $10,000.

The details of the investigation illustrate the intricacy of white-collar crime prosecution. In the third week of January, 1973 federal prosecutors issued a thousand subpeonas over the name of Assistant U.S. Attorney Russell T. Baker for records of construction, engineering, and architectural firms that had done business with the county.

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[47]Based on R.M. Cohen and J. Witcover, A Heartbeat Away--The Investigation and Resignation of Vice President Spiro T. Agnew (Viking 1974) [hereinafter Heartbeat] See also R. Nossen, The Seventh Basic Investigative Technique (Law Enforcement Assistance Administration 1975) and G. Robert Blakey and Ronald Goldstock, The Investigation and Prosecution of Organized Crime and Corrupt Activities: Official Corruption (Cornell Institute on Organized Crime 1977).



Since legitimate businesses seldom keep cash idle, attempts to raise money for kickbacks or bribes may stand out in the financial records. Agents from the I.R.S. Baltimore office searched the documents for such signs of cash accumulation. The books of Gaudreau, Inc., an architectural firm, provided the tip-off. According to the chroniclers of the Agnew resignation:

> Shortly after the firm received an installment payment from the county government for the design of a public building, it would issue a check to a corporate officer, and the amount of the check was almost always 5 per cent of the recent installment from the county. This seemed like an unmistakable method for generating cash. The Gandreau firm, the agents concluded, was probably kicking back 5 per cent of its fees.[48]

On January 25, Paul Gaudreau admitted kickbacks to William E. Fornoff, county administrator and chief aide to Baltimore Democratic boss Dale Anderson.

The subpoenaed records contained even more clues. IRS agents uncovered signs of cash generation in the books of Matz, Childs, an engineering firm. This time it was a pattern of bonuses - returnable, minus taxes, to the firm as cash - and payments for suspicious sounding consultations.

Lester Matz and John Childs, along with State Roads Commissioner Jerome Wolff, then became the investigation's targets. Matz, Child employees testifying before a grand jury under grants of use inmunity, confessed to paying back part of their bonuses. Next, Fornoff, the recipient of the kickbacks, pleaded guilty to one count of tax evasion in return for a no-jail recommendation. Then he sang for the grand jury.

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[48]Heartbeat, supra note 47, at 56.

Matz, Childs, and Wolff still held out. But with a strong case against their primary targets, government attorneys were not offering immunity. Instead Beall and his staffs applied more pressure. "Look," an assistant said to defense counsel, "the boat is filling up. When it's full it will be too late for your client."

On May 18 the prospective defendants played what they thought was their ace. Joseph Kaplan, attorney for Matz and Childs, told Baker that his clients could incriminate Vice-President Agnew, not only for his dealings as county executive (which were barred by the statute of limitations), but also for transactions while Agnew was governor andas Vice-President. The prosecutors now took aim at the big game. But without offering immunity, they pressed toward indictment of Matz and Childs.

Meantime, Wolff's lawyer, Arnold Weever, informed Beall that his client was ready to cooperate. Shortly thereafter, Matz and Childs threw in the towel.

The dam broke. Matz' attorney told of cash payments to Agnew to secure state contracts, made in the State House and later in the Old Executive Office Building. Wolff told his story on July 10. He paid cash to Agnew for appointment as chairman of the State Roads Commission, from which he in turn received payoffs to be split with Agnew and Bud Hammerman, a Maryland developer and close associate of Agnew To bolster their case against the Vice-President, the prosecutors conducted a "net worth" investigation of Agnew - a comparison of his total purchases during the period of the scheme with his total reported income for the same period. The former greatly succeeded the latter.



Hammerman's testimony clinched the case. On August 17 he described to government lawyers his role as intermediary in the kickback scheme, receiving and splitting cash with Agnew. A check of the visitor logs from the Old Executive Office Building confirmed frequent visits to the Vice-President by Hammerman and Matz. The case for conspiracy, extortion, bribery, and tax evasion was solid.

Agnew began to act. First he threatened to "go to the House," that is, to seek an inquiry in the House of Representatives calculated to embarass the White House. Attorney General Richardson then received overtures from Agnew's lawyers. An extraordinary plea bargaining episode ensued. Richardson laid down four requirements.

> First, he insisted, there must be prompt resolution of the matter--resignation--in the national interest. Second, justice must be done. Third, any agreed solution had to be publicly understandable and perceived by the public as just. Fourth, full disclosure of the facts against Agnew had to be made, preferably as part of the court record, so that the public would have a basis on which to conclude that justice had indeed been done and that the solution was equitable.[49]

On September 13, Judah Best, counsel to the Vice-President, intimated that Agnew might plead nolo contendre to one count, and resign, for a recommendation of no jail.

Richardson resisted the no-jail condition, and Agnew refused to publicly acknowledge criminal wrongdoing. Then the Vice President temporarily abandoned the negotiations and took the offensive. He told President Nixon he had decided to seek an impeachment inquiry in the House. His

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[49] Id. at 220-21.

lawyers filed a motion on September 28 to prohibit the grand jury investigation on the grounds of prejudicial publicity, and on constitutional grounds. In a speech to the National Federation of Republican Women in Los Angeles Agnew attacked Henry Peterson, now heading up the investigation, charging that the leaks to the press were deliberate and malicious, and claiming that he has been singled out for prosecution to enhance Peterson's record. The offensive backfired. An enraged Nixon ordered his Vice-President to stop attacking Peterson. The Democratic majority in the House scuttled the proposed House investigation.

Negotiations resumed on October 5. Three days later Judge Hoffman met with Agnew's lawyers, and Peterson, Beall, and Barney Skolnik, for the government. The next day they met again, this time with Richardson present. Finally, Richardson agreed to the no-jail recommendation. The deal was closed.

C. Fraud Against Business

1. Generally

The business enterprises which suffer most acutely from fraud are the larger corporations. They may be either the direct victim of fraud through loss of property or by being placed at a competitive disadvantage, or the indirect victim through public loss of confidence in business generally.[50] Business losses due to fraud may be relatively

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[50] See Herbert Edelhertz, Ezra Stotland, Marilyn Walsh, Milton Weinberg, The Investigation of White Collar Crime, (April 1977) [hereinafter Investigation].



minor and assimilable, or so massive that bankruptcy results. Consider, for example, the forced closing of 100 banks during a 20 year period primarily due to the fraudulent activities of employees acting in concert with outside confederates.[51]

Frauds against business may be perpetrated by (1) insiders acting alone - embezzlement; (2) insiders acting in concert with outsiders - commercial bribery and conflicts of interest ("where a corporate officer or employee causes his company to enter into a contractual agreement with outside firms in which he has an interest"[52]; and (3) outsiders unassisted by insiders - credit card fraud, check kiting, bank fraud, and insurance fraud.

Businesses are increasingly vulnerable to organized crime penetration. Criminal syndicates enter legitimate business through loan-sharking, enforced collection of gambling debts, and outright purchases: once inside, they execute traditional schemes like bankruptcy scams and the marketing of stolen securities by using them as collateral at banks.[53]

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[51] See Chamber of Commerce of the United States, White Collar Crime, 5 (1974).

[52] Investigation, supra note 50, at 14.

[53] Id., at 15.

2. Case Study: Arson-For Profit:

Insurance companies are easy prey for organized crime rings and unscrupulous property owners engaged in arson-for-profit, and the public pays for the insurer's vulnerability. Arson-for-profit removes buildings from the tax rolls, raises fire insurance premiums, wipes out businesses upon which entire communities rely,[54] puts the lives and properties of innocent people at risk,[55] and increases the cost of fire protection.

Arson-for-profit is our costliest and fastest growing crime, with direct losses estimated at $2 billion a year[56] and annual indirect losses estimated at $10 billion.[57] Between

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[54] See "The Sheton Affair: The Hidden Cost of Arson," Fire Journal, March 1976, at 22-24. Reprinted in Arson-For-Profit: Its Impact on States and Localities: Hearings Before the Subcommittee on Intergovernmental Relations of the Committee on Governmental Affairs, United States Senate [Ninety-Fifth Congress, First Session], at 109, December 14, 1977 [hereinafter Arson-For-Profit Hearings].

[55] Id., at 2.

[56] Senator Sam Nunn, Opening Statement, Arson-For-Hire: Hearings Before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate [Ninety-Fifth Congress, Second Session (August 23, 1978)], at 1 [hereinafter Arson-For-Hire Hearings].

[57] Arson-For-Profit Hearings, supra note 54, at 106.



1965 and 1975 the number of building arsons increased 325%[58] and continues to increase at a rate of 25% a year.[59] Unfortunately, the magnitude[60] of the arson problem is widely unappreciated because we lack a well known source of reliable statistics.[61] (Arson was just recently reclassified as a Part I crime on the F.B.I.'s Uniform Crime Report.)[62]

Whether a particular piece of property will be torched depends upon the property's profitability; as profit decreases

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[58] John F. Boudreau, Quon Y. Kwan, William E. Faragher, and Genevieve C. Denault, Arson and Arson Investigation: Survey and Assessment, 91, National Institute of Law Enforcement and Criminal Justice (October 1977) [hereinafter "Survey"].

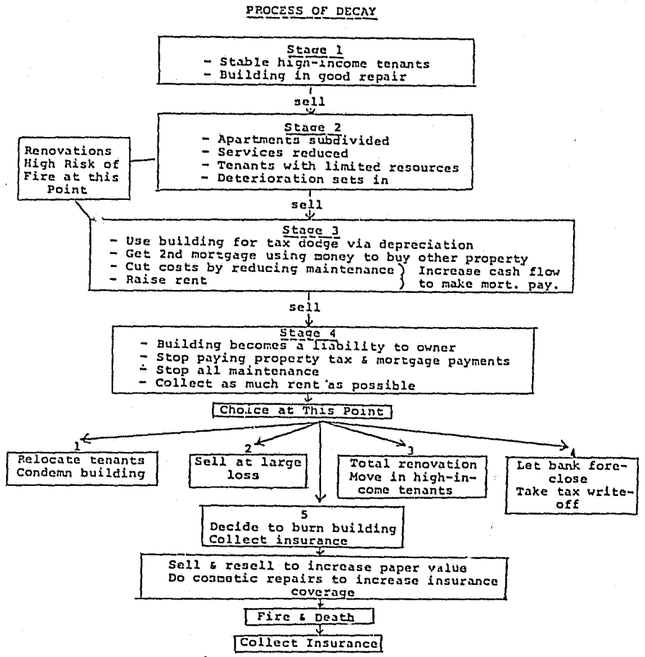
[59] Arson-For-Hire Hearings, supra note 56, at 1.

[60] Moreover, note that many experts believe that one half of all the fires that are classified as suspicious or of unknown cause are incendiary in origin. See "Survey," note 58, at 14. That would make arson the cause of 36% of the building fire losses in 1974. Id. at 5.

[61] Id., at 91.

[62] Part I crimes include: murder, rape, aggravated assault, robbery, burglary, larceny, arson and motor vehicle theft. Previously arson was classified as a Part II crime which placed it among the ranks of vagrancy, public intoxication, violating a curfew, and other petty crimes. See Senator John Glenn, Opening Statement, Arson-For-Profit-Hearings, supra note 89 at 3. It is hoped that this move will improve the statistical problem by providing a national source of arson statistics. See "Survey," supra note 54 at 91.

the probability of arson increases. The chart below[63] depicts the gradual decay of a multifamily income producing property and the likely flash points along the way.




This state of affairs gives organized crime, with its limitless resources, a made-to-order business opportunity. One commentator writes: "[T]he mob has entered the arson-for-hire market by offering something its unorganized competitors cannot, package deals, starting with the fire and ending with complete arrangements for the insurance settlement."[64]

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[63]"Arson-For-Profit-Hearing," supra note 54, at 216.

[64]Karchmer, supra note 9, at 23.



The most common financing arrangement is the free-lance contract, where a businessman, after deciding to burn his building or factory (due to operating losses, usually) shops for a torch. The mob typically demands 25 percent of the final insurance payment, with 25 percent of that amount up front.[65] The balance is due when the insurer has paid on the policy. Before the fire an insurance broker with mob connections steers the customer to an insurance company known for generous coverage and lax claims payment procedures - a company hailed for paying "in a hurry."[66] After the fire an obliging insurance adjuster makes a quick and favorable settlement. Often, a high official in the fire department is cooperating with the mob; he writes the fire off as something other than "incendiary" or "suspicious," and ensures that the best arson investigators are assigned to other fires.[67] An insurance broker, who recently pleaded guilty to arson fraud recounted: "Our group had all the elements.... We had the insurance adjuster...accommodating insurance agents, the torches, and the fire department, all working to defraud the insurance companies....We had an arson empire."[68]

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[65]In other words, the mob would take 6 and 1/4 percent of the insurance value of the property in cash, before anything was done. This payment was a way of testing the owner's "good faith." See Testimony of Angelo Monachino, Arson-For-Hire Hearings, supra note 56, at 39.

[66]Testimony of Joseph J. Carter, Arson-For-Hire Hearings, supra note 56, at 88.

[67]See Testimony of Angelo Monachino, Arson-For-Hire Hearings, supra note 56, at 40, 46.

[68]Testimony of Joseph J. Carter, Arson-For-Hire Hearings, supra note 56, at 88.

"Arson empires" run on a free-lance contract basis have generated profits in the millions. Mob figures have also used the torch as a collection device. A businessman in debt to a loan shark or a gambling syndicate may be forced to collect on his insurance policy to avoid more unpleasant inducements. Estimates are that mob-related arsons arising from gambling and loan-sharking now equal the number of business "contract" fires.[69]

D. Fraud Against Individuals

1. Generally

Individuals, we have seen, are indirectly victimized by frauds against government and business in their capacities as taxpayer and citizen, and consumer, respectively. They are also directly cheated in each capacity. Nursing home abuses, for example, fall upon individual patients entitled to quality care as citizens eligible for Medicare and Medicaid benefits. Consumer frauds typically deprive individuals of their property and too frequently their aspirations as well.

The cost cuts deep. Individuals' ability to satisfy their basic human needs is undermined by consumer frauds designed to divert the consumer's assets to the crook without giving benefit of the bargain in return. These frauds range from weight and measure or food quality frauds to home improvement and landlord misconduct, to auto repair, medical supply, and prescription drug frauds.

With respect to their aspirations, individual hopes for improved employment are dashed by phony trade and occupational schools, correspondence courses, shady talent schools

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[69] Karchmer, supra note 9, at 24-25.



and agencies.[70] Other schemes frustrate the dream of self-employment, crushing hopes for a business of one's own through franchise frauds, pyramid schemes, and vending machine frauds.[71]

2. Case Study: The Rio Rancho Real Estate Swindle[72]

Simple thievery is uniquely joined with the devastation of individual futures in the case of consumer land sale fraud. The classic case is close at hand. AMREP Corporation and its subsidiaries were in the business of buying and selling land. One of their ventures involved land in Sandoval County, New Mexico, located about fifteen to twenty miles northwest of downtown Albuquerque. Rio Rancho Estates, Inc., a subsidiary of AMREP, acquired a 91,000-acre tract of rolling hills and sandy soil, sparsely covered with sagebrush and native grasses, for a total purchase price of $17,800,000. Rio Rancho staked out the property into 86,000 lots.

It then proceeded to sell the land, centering its efforts on tightly organized and carefully scripted promotional dinners. At these affairs, the promoters explained that Albuquerque was "bursting at the seams." The city, they asserted, had "one unique, serious problem"--it was surrounded

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[70] Investigation, supra note 50, at 12.

[71] Id., at 13.

[72] The following fact pattern is drawn from United States v. AMREP Corp., 560 F.2d 539 (2d Cir. 1977), cert. denied, 434 U.S. 1015 (1978), and supplemented by Husted v. AMREP Corp., 429 F. Supp. 298 (S.D.N.Y. 1977 ), a civil action concerning the same land-sale fraud.

by mountains and government land on three sides and could grow only to the northwest, through Rio Rancho. Rio Rancho was "where the city must grow to, grow into, grow out of." The promoters also claimed that the purchase of a Rio Rancho lot would prove a safe and profitable investment. Purchasers, they contended, could make up to 25% a year from this "land investment program."

The sellers' offer and sales contract had some interesting provisions. A disclaimer in the offer stated that "resale for a profit might be difficult for a number of years." The sales contract granted the purchaser the option to cancel the contract and receive a full refund if, upon inspection of the property within six months of the sale, he was dissatisfied. The purchaser could exchange his unimproved lot without charge for an improved lot; however, only a limited amount of improved property was available for exchanges.

Many purchasers jumped at the chance to obtain land with such a rosy future, even though most of the lots were on unpaved roads and lacked utilities. By 1976, ATC Realty Corporation, another AMREP subsidiary, had sold over 77,000 lots, mostly to persons not residing in New Mexico. The lots brought a total sale price of $170,000,000, nearly ten times the original purchase price paid by Rio Rancho. The purchasers found, however, that Rio Rancho's representations were, to say the least, a bit optimistic. It turned out that Albuquerque had abundant undeveloped suburban land located closer than Rio Rancho. Moreover, the city was expanding most rapidly to the northeast, not the northwest. The promoters' projections of potential profits had been based on property dissimilar to



the Rio Rancho land. In short, the resale market for Rio Rancho lots was extremely limited. As a market survey conducted for AMREP in 1965 had predicted, Rio Rancho could likely achieve only a "small and selective market penetration" between 1966 and 1985.

## III.

## DETECTION AND INVESTIGATION OF FRAUD

Fraud is an offense that is neither readily discovered nor easily perceived as criminal; it is not simply or cheaply investigated, and not readily offered or accepted for criminal prosecution.

Both victim institutions and law enforcement agencies are responsible for identifying and preventing fraud. In practice, effective control of fraud requires a close, cooperative effort. The bureaucracies must handle the identification and prevention of low level fraud; law enforcement agencies must offer technical assistance in investigating organized frauds and accept appropriate cases for prosecution.

### A. Victim Strategies

The bureaucracies have not shouldered their burden. A recent G.A.O. report, for example, sharply criticized federal agencies for failing to act aggressively to detect program fraud. The report found that many agencies had no idea as to how much fraud existed in their programs, nor to what types of frauds their programs were most susceptible. While most agencies had collected data of individual incidents, few, if any, attempts had been made to collect and analyze the data to develop an anti-fraud strategy.[73] The study also

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[73] G.A.O. Report, supra note 23, at iii.



discovered that the agencies had no uniform policies for policing the individuals involved, and no mechanism to assure referral of suspicious matters to the Justice Department.[74]

Most agencies simply had not made fraud detection a high priority. They had not assumed a proactive posture with respect to identifying and investigating fraud, and had unjustifiably relied on state, local, or private sector institutions responsible for administering programs to identify and report frauds.[75] The need for reform was brought home by abuses in the medicare-medicaid programs, the General Services Administration, and the student loan programs, among others. Much legislation on point, including the creation of the Offices of Inspector General in executive departments and agencies, has recently been enacted, but is too early to judge the effectiveness of most of these changes.

Controlling fraud and abuse in government benefit programs requires the development of prevention, detection, and deterrent strategies for each program. To deter fraud, a recent National Institute of Law Enforcement and Criminal Justice report recommended that: (1) state Offices of Inspector General be established; (2) state and local audits and investigations be consolidated; (3) state welfare fraud statutes be enacted; (4) programs be redesigned to combat opportunities for program abuse; (5) staff

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[74] Id. at iv.

[75] Benefit Programs, supra note 24, at 47-56.

responsibilities be redesigned; (6) financial incentives be created for states to pursue fraud control; and (7) fraud and abuse research be continued.

The same report recommended with respect to detection[76] that (1) program investigatory authority be lodged in an autonomous unit; (2) internal and external fraud audits be regularly conducted; (3) computer use be expanded to screen recipients and providers; (4) employee caseload and job responsibilities be rotated; (5) the investigation team concept be used more widely; and (6) surveys and surveillance of targeted providers be conducted.

On the basis of a survey sent to all State Attorneys General and program administrators, the report concluded that no particular enforcement strategy could yet be recommended.[77] The respondents considered criminal litigation more effective than civil actions from the perspectives of monetary recoupment and deterrence. The study determined that an insufficient number of prosecutions had been recorded to assess their relative effectiveness.[78]

Administrative procedures and sanctions are viable alternatives to criminal prosecutions.[79] A permanent adjudicative

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[76] Id. at 63-77.

[77] Id. at 80.

[78] Id. at 81.

[79] Id. at 83.



structure may promote uniform handling of fraud cases, and better utilize resources than the assignment of prosecutors to small cases or to extensive training seminars to successfully try big cases. Administrative penalties which exact restitution, or suspend and terminate program participation, may be powerful tools to police providers dependent on governmental reimbursement for a substantial portion of their revenue.[80]

Business, like government, has an ethical obligation to control fraud by developing anti-fraud strategies and by cooperating with law enforcement officials. The strategies for detecting and investigating fraud in the private sector are similar to those appropriate to the public sector.

Avoiding public harm and maintaining the marketplace's integrity ought to be sufficient incentives to enlist business support in combating fraud. But more selfish motives abound. A business's reputation may be ruined by insider fraud. Note that business reputation is important on four levels: (1) within the enterprise; (2) among customers; (3) in relationships with other businesses; and (4) in the general community.[81] In addition, fraud tends to encourage other illegal activity, and thereby increases the risk of stockholder derivative suits against corporate directors and officers charged with incompetence in failing

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[80] Id. See also, Byron G. Lee, "Fraud and Abuse in Medicare and Medicaid," 30 Administrative Law Review 1 (Winter 1978).

[81] Investigation, supra note 50, at 15.

to deal with the problem.[82] In addition, evidence of fraud or vulnerability to fraud may seriously impair a company's ability to secure necessary financing and credit. Finally, if fraud or abuse is pervasive in an industry, and the industry fails to police itself, it may become the target of laws and regulations imposing costs and constraints far greater than those flowing from self-regulation.

In short, bureaucracies, public and private, need to identify the types of frauds to which they are most susceptible. Only then can they develop an adequate antifraud strategy, providing for organizational redesign, internal fraud audits, and the restructuring of management responsibilities to minimize the potential for employee self-dealing or corruption.[83] Uniform procedures must be developed for dealing with employee offenders, including referral to law enforcement authorities when appropriate. Targeted investigations of suspect employees, suppliers, officers, or purchasers, and of suspect programs, contracts, or business accounts is a must for both government agencies and public corporations.[84]

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[82] Id.

[83] Anti-fraud strategies for government agencies are developed in a state of the art study recently completed. See Benefit Programs, supra note 24; anti fraud strategies for businesses are articulated with great detail in Investigation, supra note 50, at 32-97.

[84] For a discussion of these techniques by government agencies, see, Special Agent R.P. Kusserow, Federal Bureau of Investigation, Principles of Targeting 86-167 (unpublished manual by the Chicago Division, 1979), Office of Inspector General, Dept. of Health Education and Welfare, Annual Report.



B. Law Enforcement Strategies

The uniqueness of the challenge of fraud is portrayed by the following chart - indicating the differences between fraud and predatory crimes - coupled with the realization that tools currently available to police and prosecutors are products of the fight against predatory offenses.

| PREDATORY CRIMES | FRAUD |
|---|---|
| A. OFFENDER'S CONDUCT | |
| 1. overt implementing act | 1. covert - overt acts with appearances of legitimacy |
| 2. readily identifiable as criminal | 2. not readily identifiable as criminal - may require investigation |
| 3. criminal by nature (malum in se) | 3. criminal by act (malum prohibitum) |
| 4. violent or threatening | 4. non-violent |
| 5. without victim assistance | 5. voluntary victim cooperation |
| 6. concealment of offender identity but rarely of the crime itself | 6. reliance by offender on ignorance or carelessness of victim |
| | 7. concealment of violation |
| B. IMPACT OF THE OFFENSE | |
| 1. immediate impact | 1. immediate or continuing impact |
| 2. direct injury to person's body, direct taking of person's property | 2. indirect taking of property or legal right by deceit of individual, business or public at large. |
| C. DETECTION | |
| 1. detection < victim complaints / informants | 1. detection primarily by proactive investigation by officials or by informant or victim's complaints some time after the crime. |

| | |
|---|---|
| 2. investigation simpler - does not require special professional help. | 2. investigations complex and requiring special trained investigators, auditors, prosecutors. |
| D. INVESTIGATION | |
| 3. victim has information invaluable for investigation and prosecution, willing to cooperate and testify | 3. victim often bureaucracy reluctant to cooperate and often has little knowledge of how fraud perpetrated |
| 4. alternatives are clear cut - pursue prosecution or do not. | 4. other alternatives exist beside criminal sanction - may be more appropriate, e.g. civil restitution, administrative sanctioning and mediation. |
| E. PROSECUTION | |
| 5. more serious the crime greater likelihood of successful prosecution | 5. more serious/more complex the fraud the greater the difficulty of preparing and successfully prosecuting the case. |
| 6. perpetrator often perceives himself and is perceived by the public at large as a criminal - often a recidivist | 6. perpetrator often perceives himself and is perceived as a non-criminal - rarely has a criminal record |
| F. SANCTIONING | |
| 7. sentencing is perceived as appropriate to safeguard society from a dangerous offender and as an effective deterrent. | 7. strict sentencing is perceived to be inappropriate and of questionable deterrent effect. |

These differences provide law enforcement officials with convenient rationalizations for inaction.[85] But the impact of fraud is enormous and must be met with such creative techniques as targeted investigation of suspect groups,[86] fraud audits, greater

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[85] See Investigation, supra note 50, at 8-10.

[86] See R. Kusserow, supra note 84, passim.



use of intelligence systems,[87] wiretapping, investigatory grand juries, and internal fraud-control systems.

Law enforcement may be reluctant to act to prevent and deter fraud for other reasons. Reticent investigators can fall back on several rationalizations:

(1) They lack subject matter jurisdiction.

(2) The case is more appropriate for civil action.

(3) They cannot ascertain whether a prosecutable crime has been committed until an investigation is conducted, requiring a commitment of time and manpower beyond the agency's resources.

(4) The victim invited its property loss by using sloppy internal procedures and controls.

(5) The victim's only interest is restitutionary. It will therefore be uncooperative in a criminal action which may damage its public image.

Jurisdictional problems also plague law enforcement officials in economic crime cases. Most offenses violate laws in multiple jurisdictions, either vertically (State-Federal) or horizontally (between States, between jurisdictions in one State, or between jurisdictions in the Federal Government).[88] This presents problems of coordination where two or more jurisdictions are on the case; of cooperation where one jurisdiction assumes or is ceded the laboring oar; of conflict; or of attempts to avoid responsibility by claiming another jurisdiction has

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[87] Investigation, supra note 50, at 98-121.

[88] H. Edelhertz, supra note 7, at 27.

primary responsibility.[89]

Law enforcement officials must protect the prosecutorial process from improper exploitation by private parties.[90] Where the victim's overriding concern is restitution and not retribution, there is a real danger that the criminal sanction may be abused as a device for collecting private debts. Failing to obtain restitution in a civil action because of insufficient evidence, for example, a defrauded private party may file a criminal complaint, while continuing its civil action, to obtain the benefits of a public investigation. He may be motivated by a desire to get proofs which would not be avail-

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[89]The following extract illustrates the vagaries of multi-jurisdictional crime:

> A good example of a multi-jurisdictional crime would be a charity fraud in New York which collects money in the streets and by mail and other solicitations within and outside New York. To start with, the "charity" must register with the State Department of Social Services, and it may be enjoined from operation for non-registration or for violations of the New York Social Services Law. The State attorney general would investigate. Street collections must be licensed by New York City, and while a violation would only be an offense, it would still be criminal. The local police would investigate. Collections by means of false representations would violate the State larceny statute, and thus could be prosecuted by the district attorney of any of the five counties in New York City and be investigated by the New York City Police. Interstate mail solicitations could be a violation of the Mail Fraud Statute, to be investigated by the Post Office Department. TV or radio solicitations, or use of interstate telephone lines to solicit or conduct other related business could constitute a violation of the Wire Fraud Statute, which is within the investigative jurisdiction of the FBI. There is also the parallel tax problem to be considered, with the New York State Tax Commission and the Internal Revenue Service investigating with respect to the taxability of the "charity" and its personnel. Id. at 27-28.

[90]Id. at 29.



able to him as part of civil discovery proceedings, or to exploit the possible collateral estoppel or res judicata effects of a criminal conviction.[91]

Concurrent maintenance of a civil suit and a criminal action engenders conflicting interests between law enforcement officials and victims. Civil settlement during investigation or prosecution leaves the prosecutor with a victim reluctant to testify and the inference that the conduct was not criminal but a civil abuse.[92] Moreover, the victim may be uncooperative for other reasons. He may fear the adverse publicity of a criminal action, or the possibility of political consequences (in the case of government agencies), or the possibility of exposure to civil liability for officer or director negligence (in the case of public corporations).[93]

Business victims have consequently preferred to seek restitution of defrauded property by civil suit or arbitration, followed by sanction or discharge of the offenders. The government ought to do the same, but it has neither aggressively sought restitution, nor disciplined its employee offenders.[94]

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[91]Id. at 33.

[92]Id. at 30.

[93]Investigation, supra note 50, at 10.

[94]G.A.O. Report, supra note 23, passim.

C. Case Study: Investigating Arson-For-Profit

The problems encountered in detecting and investigating arson typify those of fraud generally. A fire is assumed to be accidental or natural unless proven otherwise.[95] An investigation is necessary to establish that a crime has been committed.[96] Jurisdictional responsibility in most locales is confused; it may be with the local police, state police, local fire department, state fire prevention bureau, state fire marshal, or the insurance company involved.[97] Even when jurisdictional responsibility is clear the responsible agency often lacks the resources and trained manpower to handle the case. Since arsons are seldom witnessed,[98] the evidence required to prove intentional burning is often damaged or destroyed by the fire itself.

The rationalizations of law enforcement officials for failing to act in white collar crimes are equally available in arson, especially where no innocent parties are injured. Since investigations are time-consuming, costly, and not certain to produce a prosecutable crime, officials may treat the burning as a private problem and abandon the inquiry. This decision

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[95] Survey, supra note 58, at 31.

[96] Id. at 92.

[97] Id. at 91.

[98] Id.



rests upon a profound misimpression. Arson-for-profit[99] is not low-level program fraud but systematic fraud committed by conspiracies and organized crime rings,[100] with significant direct and indirect costs. Statutory authority[101] and existing prosecutorial tools should be utilized to take the profit out of arson.

Insurance industry practices also retard the fight against arson. Valuation[102] and adjustment procedures,[103] insurers' reluctance to fight claims or cooperate with law enforcement officials,[104] and fear of countersuits for violation of

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[99] There are six generally recognized motives for arson. Id. at 19-21. Unfortunately there is very little data as to the relative frequencies of these motives, but estimates of fraud as a motive range from 5 to 20 percent. Id. at xiv.

[100] See text accompanying note 9, supra.

[101] The criminal forfeiture provisions and civil (treble damage) provisions of R.I.C.O., 18 U.S.C. §§ 1961-1968 (1976), and traditional statutes have been used with some success. For a good discussion of the use of these various statutes to fight arson-for-profit see Matthew Gable, "Techniques in the Investigation and Prosecution of Organized Crime: Materials on RICO, (Cornell Institute on Organized Crime 1980) [hereinafter Gable] vol. 1 at 211.

[102] Insurance companies often fail to inspect either the buildings they insure or records of property value assessments or property tax payments. Nor do they consult with the owner as to the building's actual market value; nor do they inspect a building when the owner claims improvements -rather they merely increase the amount upon the owner's verbal representation. Id. at 220.

[103] Id. at 220-21.

[104] See id. at 221-22.

privacy acts[105] permit unscrupulous owners and arson rings to overinsure properties, torch them, and reap the profits without fear of prosecution.[106]

Law enforcement agencies have recently stepped up their attacks on fraud and other economic crimes. Since November 1977 the Justice Department has focused especially on white-collar crime, organized crime, official corruption, and drug trafficking.[107] On February 8, 1979, the Office of Economic Crime Enforcement was set up in the Criminal Division of the Justice Department. Within two years, similar specialized units will be established in 30 U.S. Attorney offices.[108] These units will cooperate with the LEAA financed National District Attorney's Association's Economic Crime Project units, presently operating in 34 states serving 41% of the population.[109] Based on the success of Inspector General offices in H.E.W., H.U.D. and Agriculture, similar offices were organized in seven executive departments

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[105]Includes the Federal Privacy Act of 1974, 5 USC 552(a) (1976) and various state statutes. These statutes in their aggregate prohibit the free exchange of information among insurance companies, fire marshals, and law enforcement agencies. Insurance companies are wary of releasing information that may expose them to damage suits for violation of the fiduciary relationship between policyholder and company. See id. at 222.

[106]See id. at 220-22.

[107]See Attorney General's Report on Federal Law Enforcement and Criminal Justice Assistance Activities, 68 (1979).

[108]Id.

[109]Id. at 89.



and six executive agencies.[110] As a result of the Medicare-Medicaid Anti-Fraud and Abuse Ammendments of October 25, 1977,[111] state medicaid fraud control units have been established in many jurisdictions.[112]

Fraud cases involving organized crime or public corruption may be handled by one or all of three sections of the Justice Department's Criminal Division -- the Criminal Fraud Section, the Public Integrity Section, or the Organized Crime and Racketeering Section.[113] The remaining fraud cases are handled by the Fraud Section of the Civil Division's Commercial Litigation Branch, charged with enforcement of the False Claims Act,[114] the Anti-Kickback Act,[115] the Federal Property and Administrative Services Act,[116] and the whole gamut of common-law remedies.

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[110]Inspector General Act of 1978, P.L. 95-452. Those executive departments are Agriculture, Commerce, H.U.D., Interior, Labor and Transportation. The executive agencies are Community Services Administration, E.P.A., G.S.A., N.A.S.A., S.B.A. and V.A.

[111]P.L. 95-142.

[112]State Medicaid Fraud Control Units have been created pursuant to regulations promulgated by the then Secretary of H.E.W. under his rule making power under the Social Security Act § 1102, 42 USC 1302 (1976). Those regulations were promulgated on September 29, 1978, 42 F.R. 45262 and codified in 42 CFR 455.

[113]As to the resources devoted to fight fraud and related corruption by the Justice Department, see generally Resources Devoted By the Dept. of Justice to Combat White Collar Crime and Public Corruption, Report of the Comptroller General (March 19, 1979).

[114]31 U.S.C. §§ 231 et seq. (1976).

[115]40 U.S.C. § 276(c) (1976), 41 U.S.C. §§ 51 to 54 (1976).

[116]40 U.S.C. §§ 471 et seq. (1976). Civil remedies and penalties provisions at 40 U.S.C. § 489.

IV.

PROSECUTION: THE LAW OF FRAUD

A. Historical Background

The British Law Commissioners in 1843 recognized that criminal law was the "Cinderella of jurisprudence."[117] "The criminal law," they wrote in their Seventh Report, "has suffered greatly from neglect."[118] With rules of procedure that precluded regular high court consideration, and without the economic stake to attract learned practitioners,[119] the criminal law by the nineteenth century bore even fewer traces of rational organization than the present law of federal crimes. It was simply a century's long compilation of narrowly drawn responses to narrowly conceived problems of public order. Probably the most unedifying feature of this ramshackle construction was the law of larceny,[120] and the least admired part of that was the law of fraud.

1. Larceny

The law of fraud's arrested development was assured by a rule appearing in the Year Books for 1329, which made wrongful

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[117] A. Ashworth, "The Making of the English Criminal Law (4) Blackstone, Foster and East" 1978 Crim. L. Rev. 389 (1978).

[118] Id.

[119] Id.

[120] See J. Kaye, "The Making of English Criminal Law (1) The Beginnings-A General Survey of Criminal Law and Justice Down to 1500," 1977 Crim. L. Rev. 4,11 (1977).



taking an indispensable element of larceny. The effect was to exclude from the felony sanction any misappropriation where possession was originally accomplished with the owner's consent.[121] Obtaining title by false pretences was similarly unindictable. Stephen later speculated that the holding was rooted in the sentiment that "against open violence people ought to be protected by law, but that they could protect themselves against breaches of trust by not trusting people."[122] Chief Justice Holt put this rather severe metaphysic differently: "Shall we indict one man for making a fool of another?"[123]

'Not trusting people' proved an unmanageable social ethic. The increasingly commercial English economy ran on transactions between remote parties personally unacquainted, and merchants required more security of exchange than that provided by "caveat emptor." The common-law judges responded by broadly interpreting the "possession" requirement of larceny. The trend started with Carrier's Case in 1474.[124] The defendant carrier, having agreed to transport bales of merchandise to Southampton, broke open the bales and made off with the contents. The Court wanted to sustain the indictment, but floundered on how to square that result with the Common law. The Chancellor, unhappy with the

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[121] Id.

[122] 3 J. Stephen, A History of the Criminal Law of England, 124 (1883).

[123] 2 W. Russell, A Treature on Crimes and Misdemeanors, 520-21 (1877).

[124] J. Kaye, supra note 121, at 11.

trespassory taking requirement, argued that larceny should depend upon the fraudulent intent of the defendant. Justice Choke maintained that the carrier took possession only of the container, and that the owner continued to possess the contents. Neither persuaded a majority. The decision affirmed the common-law rule, but determined that "breaking bulk" terminated the bailment, thus rendering conversion of the contents a new "taking" from the owner's possession.[125]

Later decisions further expanded the concept of "possession." Particularly useful was the notion of "constructive possession," which extended larceny to, for example, a servant's misappropriation of his master's property. As one commentator explained; "A man who tells his servant to hold his horse for him . . . was felt to retain his control over the horse" as if he held the bridle in his own hand. "[I]t was accordingly asserted that if the servant . . . made away with the thing in his charge, he was guilty of theft."[126] The doctrine might also apply to a guest who steals the cup his host has graciously allowed him to drink from. In both cases, the owner's presence constituted "possession."

During the eighteenth century, the doctirne of "constructive possession" was supplemented by what was then generally called "larceny by trick." But for the judges' insistence on

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[125] 3 J. Stephen, supra note 122, at 139.

[126] Id. at 151.



cabining the facts within the traditional definition of larceny, we would say they were punishing fraud. "Larceny by trick" involved a thief who, intending to convert the victim's property, obtained actual possession through false representations. In Pear's Case[127] the defendant rented a horse, planning all the while to sell it and to keep the proceeds. Held indictable because the owner retained "possession," in some sense, until the time of sale.

2. Fraud

Acquiring title to the horse, or the "property" in it, by false pretences was not larceny. A contrary holding would have required a clean break with precedent - by what fiction could the voluntary transfer of title and possession be designated felonious? - and there were several reasons for the courts' reluctance to take the giant step. One was lingering affection for the rule of caveat emptor. As late as 1761, Lord Mansfield dismissed an indictment for fraud, castigating the plaintiff instead for his own carelessness in the marketplace.[128] A more important reason was the English constitutional struggle. Parliament had gradually secured the judges' respect, and the courts evinced a willingness to pass responsibility for legal reform to the legislature.[129] In addition, judicial sympathy

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[127] 168 Engl. Rep. 208 (K.B. 1779).

[128] 2 W. Russell, supra note 123, at 522.

[129] Model Penal Code § 206, Appendix A (Tent-Draft No.1, 1952).

for the concept of natural law rendered judges "interpreters of immemorial custom rather than framers of policy."[130] Perhaps most significantly, the eighteenth century punishment for all but petty larceny was capital punishment, and courts were doubtless reluctant to condemn mere defrauders to death.[131]

By the middle of the eighteenth century, then, there was still no general crime of fraud. "Cheating," defrauding by means inimical to the public generally (by false weights or tokens, for instance), had long been a misdemeanor at common law,[132] but only civil remedies were available to redress the acquisition of title through false representations. Then, in 1757, Parliament passed a statute apparently intended to fill the gap.

> Whereas divers ill-disposed persons, to support their profligate way of life, have by various subtle strategems, threats and devices, fraudulently obtained divers sums of money, goods . . . all persons who knowingly and designedly, by false pretence, or pretences, shall obtain from any person or persons, money, goods, wares, or merchandizes, with intent to cheat or defraud any person or persons of the same . . . shall be deemed offenders [misdemeanants][133]

The statute was not authoritatively interpreted until 1789. The hapless complainant in Young v. The King[134] was

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[130] Id.

[131] Id.

[132] 2. W. Russell, supra note 123, at 522.

[133] J. Hall, Theft, Law and Society, 40 (1952).

[134] 100 Eng. Rep. 475 (K.B. 1789).



persuaded to contribute 20 guineas toward a wager on a race from Gloucester to Bristol. The defendants, who never placed the bet, were successfully prosecuted for fraud. Justice Ashurst, displaying an attitude strikingly different from his predecessors, reasoned that "[t]he Legislature saw that all men were not equally prudent, and this statute was passed to protect the weaker part of mankind."[135]

The Young decision, by according the false pretenses statute a scope coextensive with its broad, sweeping language, removed the last impediment obstructing the development of a general law of fraud. Subsequent decisions further defined the conduct prohibited by the statute. In perhaps the most significant development, an 1805 court held that the defrauder's acts could constitute false pretenses - oral representations were not necessary.[136]

The developments in the English common law had a profound effect on the criminal law of the American states. Even today, most states retain the separation of larceny and theft by false pretenses.[137] These offenses, together with the crime of embezzlement, constitute the entire law of theft.[138] The passage of time, however, has revealed both theoretical and practical difficulties

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[135] 100 Eng. Rep. at 478.

[136] Rex v. Story, 168 Engl. Rep. 695,696 (1805).

[137] W. LaFave, A. Scott, Handbook on Criminal Law, 622 (1972) [hereinafter LaFave and Scott.]

[138] Id. at 673.

with this tripartite division. Distinctions between offenses are often arbitrary and difficult to maintain. Larceny by trick, for example, requires the obtaining of possession, while theft by false pretenses requires the obtaining of possession and title. Whatever the merit of defining entirely separate offenses by reference to technical property concepts, the distinction is difficult to draw when, for instance, the defendant purchases property from the complainant on conditional sale.[139] Blurry distinctions have also encouraged what LaFave and Scott call "a favorite indoor sport played for high stakes in our appellate courts: A defendant, convicted of one of the three crimes, claims on appeal that, though he is guilty of a crime, his crime is one of the other two."[140]

Some modern drafters, lacking the "sporting" instinct, have recognized that the tripartite division merely complicates the work of courts and prosecutors and provides the thief a means of avoiding or postponing punishment. They have attempted to avoid these drawbacks by consolidating all three offenses into one general crime of theft.[141] The next section examines this modern trend, focusing on the approach taken by the Model Penal Code.

B. The Model Penal Code Approach

The Model Penal Code combines larceny, embezzlement, false

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[139] Id. at 675.

[140] Id. at 673.

[141] Id. at 677.



pretenses, and several other property offenses into one general crime of theft.[142] It then classifies theft into several types, based upon the circumstances attending the theft or upon the nature of what is stolen.[143] At first glance, we might wonder what the drafters accomplished by abolishing the traditional distinctions, merely to replace them with a new classification. The consolidation, however, goes a long way toward meeting the problems mentioned in the previous section. First, it achieves simplicity and rationality by grouping together and according similar punishment to crimes that are essentially the same. Second, it eliminates the guilty defendant's claim or appeal that he was convicted of the wrong offense. Section 223.1 provides that "[a]n accusation of theft may be supported by evidence that it was committed in any manner that would be theft under this Article, notwithstanding the specification of a different manner in the indictment or information." The only limitation on discrepancies between the indictment and evidence at trial is the defendant's right to fair notice of the crime charged.[144]

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[142] See Model Penal Code § 223 (Proposed Official Draft 1962).

[143] The several types are: theft by unlawful taking or disposition (§223.2); theft by deception (§223.3); theft by extortion (§223.4); theft of property lost, mislaid, or delivered by mistake (§223.5); receiving stolen property (§223.6); theft of services (§223.7); theft by failure to make required disposition of funds received (§223.8); and unauthorized use of automobiles and other vehicles (§223.9).

[144] Model Penal Code §223.1 (1) (Proposed Official Draft 1962).

Section 223.3 relates most directly to crimes of fraud. It provides as follows:

> A person is guilty of theft if he obtains property of another by deception. A person deceives if he purposely:
>
> (a) creates or reinforces a false impression, including false impressions as to law, value, intention or other state of mind; but deception as to a person's intention to perform a promise shall not be inferred from the fact alone that he did not subsequently perform the promise; or
>
> (b) prevents another from acquiring information which would affect his judgment of a transaction; or
>
> (c) fails to correct a false impression which the deceiver previously created or reinforced, or which the deceiver knows to be influencing another to whom he stands in a fiduciary or confidential relationship; or
>
> (d) fails to disclose a known lien, adverse claim or other legal impediment to the enjoyment of property which he transfers or encumbers in consideration for the property obtained, whether such impediment is or is not valid, or is or is not a matter of official record.
>
> The term "deceive" does not, however, include falsity as to matters having no pecuniary significance, or puffing by statements unlikely to deceive ordinary persons in the group addressed.

1. Elements of the Offense

a. Conduct

Section 223.3 requires the prosecution to show that the defendant obtained the property of another. The defendant "obtains" property when he "bring[s] about a transfer or purported transfer of a legal interest," whether to himself or to a third party.[145] "Property" includes "anything of value."[146] The phrase "of another" merely requires that some person have "an interest which the [defendant] is not privileged to infringe."[147] Thus the statute generally applies to property in which both the defendant and victim have interests; an exception excludes property in the defendant's possession if the complaintant has only a security interest.[148]

b. Attendant Circumstances

The second element of a section 223.3 violation is deception. Under subsection (a), the thief deceives the victim when he "creates or reinforces a false impression." In proscribing creation of a false impression, the drafters merely intended to rephrase the traditional "misrepresentation" requirement; the provision effects no substantive change but simply codifies the common-law decisions prohibiting "deceptive non-verbal behavior."[149] The "reinforcing" language, however, extends more broadly to reach cases where the defendant "confirms [a prior] false impression for the purpose of inducing consent."[150]

The statute does not require that the defendant's representations be false, but rather that the impression created be false.[151] Thus, "statements which are literally true, but misleading be-

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[145] Id. §223.0 (5).

[146] Id. §223.0 (6).

[147] Id. §223.0 (7).

[148] Id.

[149] Model Penal Code §206.2, Comment (Tent. Draft No.2, 1954).

[150] Id.

[151] Id.

cause of the omission of necessary qualifications" may suffice.[152]

Subsections (b), (c), and (d) deal with cases where the defrauder does not actually communicate misleading information to the victim, but takes advantage of the victim's ignorance. The drafters treaded carefully here, in an effort to avoid "jeopardizing normal business practices or entering the field of controversial moral obligations."[153] The provisions thus do not broadly prohibit such overreaching--they just establish certain "special circumstances imposing a duty to correct the [victim's] mistake."[154]

There is no restriction on the subject matter of the "false impression" required under subsections (a) and (c). The Code thus rejects the traditional requirement that the thief's deception relate to existing fact,[155] and reaches all "false impressions as to law, value, intention or other state of mind.[156] The drafters recognized that such a broad provision might permit creditors to allege that a defaulting debtor created a false impression that he would pay a debt.[157] Therefore, subsection (a)

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[152] Id.

[153] Id.

[154] Id.

[155] Id.

[156] Model Penal Code §223.3(a) (Proposed Official Draft 1962).

[157] Model Penal Code §206.2, Comment (Tent Draft No.2, 1954).



protects debtors from harassment by precluding an inference of deception from the mere failure to pay.[158]

The last paragraph of Section 223.3 carves out two exceptions to the definitions of deception contained in subsections (a) through (d). First, it excludes deception "as to matters having no pecuniary significance," on the theory that non-pecuniary matters do not relate closely to the protection of property interests.[159] Second, it protects mass advertising[160] by exempting "puffing" that is "unlikely to deceive ordinary persons in the group addressed." The drafters recognized that such advertising might "mislead a fringe group of the exceptionally gullible."[161] They adopted an "ordinary person" standard so as not "to create a pressure for communication in terms suitable to the most stupid."[162]

c. State of Mind

Section 223.3 does not associate any particular state of mind requirement with the conduct element of obtaining the property of another. Under one of the Code's general rules of construction,[163] it is, however, proper to imply a requirement

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[158] Id.

[159] Id.

[160] Id.

[161] Id.

[162] Id.

[163] Model Penal Code §2.02(3) (Proposed Official Draft 1962).

of recklessness.[164] Nevertheless the Code allows the defendant in a theft case to plead as an affirmative defense that he "was unaware that the property or service was that of another."[165]

In contrast, Section 223.3 explicitly requires purposefulness to accompany the attendant circumstance of deception. The defrauder must not only intend to mislead the victim, but he must also mislead for the purpose of persuading the owner to give up his property.[166]

2. Modern State Codes--The Influence of the Model Penal Code

In attacking fraud, many of the more populous states have recognized the advantages of statutory consolidation. Pennsylvania and New Jersey, for example, have adopted the Code's theft provisions.[167] Florida, Massachusetts, and New York, on the other hand, achieve consolidation through a general theft or larceny statute which explicitly includes the various common-law theft offenses.[168] All five states retain other provisions combating particular types of fraud.[169]

C. The Federal Law of Fraud

The mail[170] and wire[171] fraud statutes are the basic

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[164]"When the culpability sufficient to establish a material element of an offense is not prescribed by law, such element is established if a person acts purposely, knowingly, or recklessly." Id. Thus, the minimum state of mind requirement is recklessness.

[165]Id. §223.1 (3)(a).

[166]Model Penal Code §206.2, Comment (Tent. Draft No.2, 1954).

[167]See N.J. Stat. Ann §§ 2C:20-1 to 20-10 (West Special Pamphlet 1979); 18 Pa.Cons. Stat. Ann.§§ 3901-3928 (Purdon 1973).

[168]See Fla. Stat. Ann. §812.012, 812.014 (West Supp. 1978); Mass. Ann. Laws ch. 266, §30 (Michie Law. Co-op); N.Y. Penal Law §155.05 (2)(a), (2)(d) (McKinney 1975).



[169]See, e.g., Fla. Stat. Ann §§817.01--.561 (1976 & West Supp. 1978); Mass. Ann. Laws ch 266, §31; N.J. Stat. Ann. §2C:21 (West Special Pamphlet 1979); N.Y. Penal Law §§ 170.00-190-65 (McKinney 1975 and Supp. 1979); 18 Pa. Cons. Stat. Ann. §§ 4101-4116 (Purdon 1973 and Supp. 1978).

[170]18 U.S.C. § 1341 (1976) provides:

> Frauds and swindles
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> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

[171]18 U.S.C. § 1343 (1976) provides:

> Fraud by wire, radio, or television
>
> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

federal antifraud provisions.[172] Repeat offenders may engage in a "pattern of racketeering activity" and thereby also run afoul of the Racketeer Influenced and Corrupt Organizations Act.[173]

1. Mail and Wire Fraud

a. Purpose

The purpose of the mail and wire fraud statutes is to prevent the use of the Postal Service and interstate communication facilities to effect fraudulent schemes.[174] The two statutes are in pari materia; cases construing the mail fraud statute are applicable to wire fraud.[175] Thus, the materials below that focus on mail fraud are relevant to wire fraud as well.

b. Elements of Mail Fraud

The mail fraud statute provides in pertinent part:

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[172] See generally Senate Comm. on the Judiciary, 93d Cong., 2d Sess., Criminal Justice Codification Revision, and Reform Act of 1974, 685-91 (1975); Note, "A Survey of the Mail Fraud Act," 8 Mem. St. U.L. Rev. 673 (1978); Comment, "Survey of the Law of Mail Fraud," 1975 U. Ill. L.F. 237; Criminal Division, Executive Office for U.S. Attorneys, U.S. Dep't of Justice, U.S. Attorneys' Manual Title 9, chs. 43-44 (May 23, 1978).

[173] 18 U.S.C. §§ 1961-1968 (1976).

[174] Parr v. United States, 363 U.S. 370, 389 (1960); Durland v. United States, 161 U.S. 306, 314 (1896); United States v. Keane, 522 F.2d 534 544 (7th Cir. 1975), cert. denied, 424 U.S. 976 (1976).
Although the stated purpose of § 1341 is prevention of misuse of the mails, the real target of the statute is fraud. The federal government cannot reach conduct controlled by the state fraud laws without a federal basis for jurisdiction. Thus, although the true purpose of the mail and wire fraud statutes is to prevent the perpetration of fraudulent schemes, the stated purposes focus upon the U.S. Postal Service and interstate commerce.

[175] United States v. Tarnopol, 561 F.2d 466, 475 (3d Cir. 1977); United States v. Donahue, 539 F.2d 1131, 1135 (8th Cir. 1976).



> Whoever, having devised or intending to devise, any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, . . . for the purpose of executing such scheme or artifice or attempting to do so, places in any post office . . . any matter . . . to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter . . . or knowingly causes to be delivered by mail . . . any such matter . . . shall be fined . . . or imprisoned . . . or both.[176]

The elements of the offense are:

(1) a scheme to defraud, and

(2) use of the mails.[177]

i. Scheme to Defraud

(A) Conduct

The concept of a scheme to defraud is broad and inclusive--any scheme involving trickery or deceit is within the statute.[178] In Isaacs v. United States,[179] the court discussed the nature of fraud:

> [W]e recognize that the forms of fraud are as multifarious as human ingenuity can devise; that courts consider it difficult, if not impossible, to formulate an exact, definite, and all-inclusive definition thereof; and that each case must be determined on its own facts. In general, and in its generic sense, fraud comprises all

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[176] 18 U.S.C. § 1341 (1976).

[177] Pereira v. United States, 347 U.S. 1, 8 (1954); United States v. Sparrow, 470 F.2d 885, 889 (10th Cir. 1972), cert. denied, 411 U.S. 936 (1973); Blachly v. United States, 380 F.2d 665, 671 (5th Cir. 1967). Cf. United States v. Pearlstein, 576 F.2d 531, 534 (3d Cir. 1978) (third element is "culpable participation by the defendant").

[178] Criminal Justice Codification, Revision, and Reform Act of 1974, supra note 172, at 686.

[179] 301 F.2d 706 (8th Cir.), cert. denied, 371 U.S. 818 (1962).

> acts, conduct, omissions, and concealment involving breach of legal or equitable duty and resulting in damage to another.[180]

The courts have held that a "scheme or artifice to defraud" includes land sale schemes,[181] advance fee rackets,[182] schemes to defraud investors,[183] schemes to defraud insurance companies,[184] schemes involving breach of official or fiduciary duties or

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[180] Id. at 713. Cf. Weiss v. United States, 122 F.2d 675, 681 (5th Cir.), cert. denied, 314 U.S. 687 (1941), where the court stated, "[t]he law does not define fraud; it needs no definition; it is as old as falsehood and as versable as human ingenuity."
See also Ballentine's Law Dictionary 1249 (3d ed. 1969) (definition of swindling); Black's Law Dictionary 788 (rev. 4th ed. 1968) (definition of fraud; actor intends to deprive another of something he rightfully holds or to do him an injury by means of perversion of the truth, false representations, employment of an artifice, or concealment of the truth).

[181] E.g., United States v. AMREP Corp., 560 F.2d 539 (2d Cir. 1977), cert. denied, 434 U.S. 1015 (1978); Lustiger v. United States, 386 F.2d 132 (9th Cir. 1967), cert. denied, 390 U.S. 951 (1968).

[182] E.g., United States v. Sampson, 371 U.S. 75 (1962); United States v. Kaplan, 554 F.2d 958 (9th Cir.), cert. denied, 434 U.S. 956 (1977); Gusow v. United States, 347 F.2d (10th Cir.), cert. denied, 382 U.S. 906 (1965).

[183] E.g., Deaver v. United States, 155 F.2d 740 (D.C. Cir.) (burial lots), cert. denied, 329 U.S. 766 (1946); United States v. Culver, 224 F. Supp. 419 (D. Md. 1963) (savings and loan associations).

[184] E.g., United States v. Cady, 567 F.2d 771 (8th Cir. 1977), cert. denied, 435 U.S. 944 (1978); United States v. Unger, 295 F.2d 889 (7th Cir. 1961).



breach of trust,[185] merchandising schemes,[186] securities frauds,[187] tax frauds,[188] planned bankruptcy schemes,[189] debt consolidation schemes,[190] credit card schemes,[191] chain referral schemes,[192] schemes involving false applications or statements to obtain

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[185] E.g., United States v. Rabbitt, 583 F.2d 1014 (8th Cir. 1978) (official corruption), cert. denied, 99 S. Ct. 1022 (1979); United States v. Hasenstab, 575 F.2d 1035 (2d Cir.) (breach of employee's duties to employer), cert. denied, 99 S. Ct. 100 (1978); United States v. Staszcuk, 502 F.2d 875 (7th Cir. 1974) (official corruption), modified, 517 F.2d 53, cert. denied, 423 U.S. 837 (1975); United States v. George, 477 F.2d 508 (7th Cir.) (breach of employee's duties to employer), cert. denied, 414 U.S. 827 (1973); Shushan v. United States, 117 F.2d 110 (5th Cir.) (official corruption), cert. denied, 313 U.S. 574 (1941); United States v. Proctor & Gamble Co., 47 F. Supp. 676 (D. Mass. 1942) (breach of employee's duties to employer).

[186] E.g., United States v. Press, 336 F.2d 1003 (2d Cir. 1964), cert. denied, 379 U.S. 965 (1965).

[187] E.g., United States v. Sparrow, 470 F.2d 885 (10th Cir. 1972), cert. denied, 411 U.S. 936 (1973).

[188] E.g., United States v. Mirabile, 503 F.2d 1065 (8th Cir. 1974), cert. denied, 420 U.S. 973 (1975).

[189] E.g., Jacobs v. United States, 395 F.2d 469 (8th Cir. 1968).

[190] E.g., United States v. Bertin, 254 F. Supp. 937 (D. Md. 1966).

[191] E.g., United States v. Maze, 414 U.S. 395 (1974); Parr v. United States, 363 U.S. 370 (1960); United States v. Kelem, 416 F.2d (9th Cir. 1969), cert. denied, 397 U.S. 952 (1970); Adams v. United States, 312 F.2d 137 (5th Cir. 1963).

[192] E.g., Blachly v. United States, 380 F.2d 665 (5th Cir. 1967).

credit or loans,[193] election frauds,[194] franchise schemes,[195] work-at-home schemes,[196] correspondence school schemes,[197] check-kiting,[198] marital schemes,[199] divorce mills,[200] and charitable frauds.[201]

As the statutory language implies, the scheme to defraud need not aim at obtaining tangible possessions.[202] Thus, a scheme directed at depriving an employer of the faithful ser-

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[193] E.g., United States v. Young, 232 U.S. 155 (1914); United States v. Blassingame, 427 F.2d 329 (2d Cir 1970) (wire fraud), cert. denied, 402 U.S. 945 (1971); United States v. Hancock, 268 F.2d 205 (2d Cir.), cert. denied, 361 U.S. 837 (1959).

[194] E.g., United States v. States, 488 F.2d 761 (8th Cir.), cert. denied, 417 U.S. 909 (1973).

[195] E.g., United States v. Pearlstein, 576 F.2d 531 (3d Cir. 1978) (pen marketing distributorships); Irwin v. United States, 388 F.2d 770 (9th Cir. 1964) (mail order franchises), cert. denied, 381 U.S. 911 (1965).

[196] E.g., United States v. Baren, 305 F.2d 527 (2d Cir. 1962).

[197] E.g., Babson v. United States, 330 F.2d 662 (9th Cir.), cert. denied, 377 U.S. 993 (1964).

[198] E.g., United States v. Foshee, 569 F.2d 410 (5th Cir. 1978); Williams v. United States, 278 F.2d 535 (9th Cir. 1960).

[199] E.g., Pereira v. United States, 347 U.S. 1 (1954).

[200] E.g., United States v. Edwards, 458 F.2d 875 (5th Cir.), cert. denied, 409 U.S. 891 (1972).

[201] E.g., Koolisk v. United States, 340 F.2d 513 (8th Cir.), cert. denied, 381 U.S. 951 (1965).

[202] United States v. States, 488 F.2d 761, 764 (8th Cir.), cert. denied, 417 U.S. 909 (1973).



vices of an employee,[203] depriving citizens of the honest and faithful services of a public official,[204] or depriving the public of its right to honest and representative government[205] falls within the section.

(B) State of Mind

The defendant must intend to execute the scheme to defraud.[206] This state of mind requirement breaks down into two parts:

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[203] E.g., United States v. George, 477 F.2d 508 (7th Cir.), cert. denied, 414 U.S. 827 (1973); United States v. Proctor & Gamble Co., 47 F. Supp. 676 (D. Mass. 1942).
In George, the cabinet buyer for Zenith took kickbacks from the cabinet maker in exchange for preferential treatment. The court held:

> Here the fraud consisted in [the defendant's] holding himself out to be a loyal employee, acting in Zenith's best interests, but actually not giving his honest and faithful services, to Zenith's real detriment.

477 F.2d at 513.

Similarly, the court held in Proctor & Gamble that by

> by causing Lever Brothers' employees to reveal their employer's trade secrets, the defendants defrauded the employer of its "lawful right" to his employees' loyal and honest services. 47 F. Supp. at 678.

[204] E.g., United States v. Isaacs, 493 F.2d 1124 (7th Cir.) (bribery of governor), cert. denied, 417 U.S. 976 (1974); Shushan v. United States, 117 F.2d 110 (5th Cir.) (bribery of Lever Board member), cert denied, 313 U.S. 574 (1941).

[205] E.g., United States v. States, 488 F.2d 761 (8th Cir.) (election fraud), cert. denied, 417 U.S. 909 (1973).

[206] See Durland v. United States, 161 U.S. 306, 313 (1896); United States v. Sparrow, 470 F.2d 885, 889 (10th Cir. 1972), cert. denied, 411 U.S. 936 (1973); Williams v. United States, 278 F.2d 535, 537 (9th Cir. 1960).

(1) intent to deprive another of something, to harm another, or to gain a benefit for oneself; and

(2) recklessness as to the truth or falsity of representations made in the course of the scheme.

First, the accused must intend the result of his scheme. He must intend to deprive another of something of value, to do some injury to another, or to gain a benefit for himself by means of such harm or deprivation.[207] It follows that good faith is a complete defense to a charge of mail fraud, because it negates intent.

When the scheme involves depriving persons of money or property, the requisite intended result is evident. A scheme contemplating harm to an intangible right, however, presents more difficult problems in ascertaining intent.[208]

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[207] See United States v. Mandel, 415 F. Supp. 997, 1005 (D. Md. 1976), rev'd on other grounds, 591 F.2d 1347 (4th Cir. 1979).

Intent as to result, according to several courts, is an intent "to deceive persons of ordinary prudence and comprehension." Blachly v. United States, 380 F.2d 665, 671 (5th Cir. 1967); Gusow v. United States, 347 F.2d 755, 756 (10th Cir.), cert. denied, 382 U.S. 906 (1965); Silverman v. United States, 213 F.2d 405, 410 (5th Cir.), cert. denied, 348 U.S. 828 (1954). Cf. United States v. Regent Office Supply Co., 421 F.2d 1174, 1182 (2d Cir. 1970) (sales pitch not in violation of § 1341; insufficient evidence that the scheme contemplated any harm or injury).

[208] Comment, "Survey of the Law of Mail Fraud," 1975 U. Ill. L.F. 237, 245-48.



Second, the defendant must be reckless as to the truth or falsity of representations made in the course of the scheme.[209] He need not know that his representations are false or misleading; his recklessness in failing to acquire that knowledge is sufficient. State of mind is rarely amenable to direct proof; therefore, the prosecutor or plaintiff must often use circumstantial evidence.[210] Intent to deprive or harm another or to benefit oneself may be inferred, for example, from evidence of an actual deprivation, a harm inflicted, or a benefit gained.[211] In the Rio Rancho fact pattern, the prosecution could establish state of mind by introducing evidence showing

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[209] United States v. Pearlstein, 576 F.2d 531, 537 (3d Cir. 1978); United States v. Henderson, 446 F.2d 960, 966 (8th Cir.), cert. denied, 404 U.S. 991 (1971); Irwin v. United States, 338 F.2d 770, 774 (9th Cir. 1964), cert. denied, 381 U.S. 911 (1965).

[210] Aiken v. United States, 108 F.2d 182 (4th Cir. 1939). The court discussed the circumstances from which intent could be inferred:

> Fraudulent intent . . . is too often difficult to prove by direct and convincing evidence. In many cases it must be inferred from a series of seemingly isolated acts and instances which have been rather aptly designated as badges of fraud. When these are sufficiently numerous they may in their totality properly justify an inference of a fraudulent intent . . .

Id. at 183.

[211] United States v. Meyer, 359 F.2d 837, 839-40 (7th Cir.), cert. denied, 385 U.S. 837 (1966).

The converse is also true. "[T]he failure to benefit from a scheme . . . may mirror the defendant's good faith." Id. at 840.

that the purchasers suffered financial losses from their unprofitable investments and that the schemers enjoyed unreasonably large profits.

Another possible source of circumstantial evidence is the defendant's conduct in the execution of the scheme. The prosecutor may introduce evidence of deceptive conduct, such as false or misleading representations[212] or non-disclosure or concealment of material facts,[213] from which the jury may infer an intent to defraud. For example, the Government could show that the AMREP salesmen made false representations and promises to encourage land purchases. Claims that Albuquerque must grow through Rio Rancho were false because other land was available for expansion. Promises as to the future profitability of the land investment program never came true; the land's value did not appreciably increase. Moreover, important facts were concealed from the purchasers. The report done for AMREP indicated the resale market for Rio Rancho lots would be poor for at least twenty years. Defendants concealed this information from the purchasers, even though it was relevant to the transaction.

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[212]Misrepresentations as to intentions regarding future acts were not subject to prosecution at common law; however, this common law rule does not restrict the mail fraud statute. "[I]t includes everything designed to defraud by representations as to the past or present, or suggestions or promises as to the future." Durland v. United States, 161 U.S. 306, 313 (1896).

[213]Non-disclosure and concealment most commonly arise in political corruption cases. See, e.g., United States v. Mandel, 591 F.2d 1347 (4th Cir. 1979); United States v. Rabbitt, 583 F.2d 1014 (8th Cir. 1978), cert. denied, 99 S. Ct. 1022 (1979); United States v. Isaacs, 493 F.2d 1124 (7th Cir.), cert. denied, 417 U.S. 976 (1974).



Courts do impose limits, however, on circumstantial evidence. A misrepresentation must relate to what is bargained for to be evidence of intent to defraud;[214] the defrauder must deceive his victim as to the quality or nature of the deal. Land schemers must convince the purchasers that desert land is a profitable investment; insurance company defrauders must convince the company that the personal injury claims are genuine;[215] the bribed official must convince the public that it is receiving his honest and loyal services.[216] Evidence of misrepresentations about unimportant or extraneous matters does not suffice.[217]

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[214]See United States v. Pearlstein, 576 F.2d 531, 544 (3d Cir. 1978); United States v. Regent Office Supply Co., 421 F.2d 1174, 1182 (2d Cir. 1970).

[215]United States v. Unger, 295 F.2d 889, 890 (7th Cir. 1961).

[216]United States v. Staszcuk, 512 F.2d 875, 877 (7th Cir. 1974), modified, 517 F.2d 53, cert. denied, 423 U.S. 837 (1975).

[217]In Pearlstein, the appellants were salesmen for GMF/ElginPen. As part of their sales pitch to potential distributorship purchasers the salesmen exaggerated their roles in the company's operation and made false statements about their own business backgrounds. The court held that:

> such misrepresentations did not relate to the essential feature of their presentations . . . and hardly can be construed as fraudulent.

576 F.2d at 544.

In Regent, stationery salesmen gained the sympathetic ear of their customers by making false statements regarding being referred to the customer by a friend, being a professional person, or needing to dispose of stationery due to the death of a friend. The court held that evidence of such statements alone showed no attempt to deceive as to the bargain being offered and, therefore, no fraudulent scheme. The court further stated:

> Where the false representations are directed to the quality, adequacy, or price of the goods themselves, the fraudulent intent is apparent because the victim is made to bargain without facts obviously essential in deciding whether to enter the bargain.

421 F.2d at 1182.

Furthermore, a seller's puffing or innocent exaggeration of the qualities his wares possess is not sufficient circumstantial evidence.[218] If the seller goes beyond mere puffing, however, and makes false statements, and then acts fraudulently, his conduct allows the finder of fact to infer intent from result.

Similarly, recklessness regarding the truthfulness of represtntations may be established by the facts and circumstances surrounding the transaction. If the schemer is put on notice of the possibility that his claims are false, and yet he continues to make the same representations, a jury may infer his reckless disregard of their validity.[219] For example, a scheme in which the perpetrator induces the victim to invest money for future profits usually involves representations as to the amount of profit to be realized. But if the "business" is new, the perpetrator does not know whether his facts and figures are accurate. His failure to inquire into their accuracy may lead to an inference that he is indifferent to the truth.[220]

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[218] Comment, "Survey of the Law of Mail Fraud," 1975 U. Ill. L.F. 237, 244.
On sellers' puffing, see generally Comment, "Mail Fraud-Fraudulent Misrepresentations Must Be Distinguished from 'Puffing' or 'Sellers' Talk' in Offenses Under 18 U.S.C. § 1341," 22 S.C.L. Rev. 434 (1970).

[219] United States v. Press, 336 F.2d 1003, 1011 (2d Cir. 1964), cert. denied, 379 U.S. 965 (1965).

[220] United States v. Pearlstein, 576 F.2d 531, 537 (3d Cir. 1978) (reckless disregard for validity of revenue projections used in promoting sale of distributorships); Irwin v. United States, 338 F.2d 770, 774 (9th Cir. 1964) (reckless indifference as to truth of representations that mail order franchises would be profitable), cert. denied, 381 U.S. 911 (1965).



In the land fraud case, the promoters projected future profits from investment in Rio Rancho, using examples of dissimilar Albuquerque property. The properties were different, and the profits were likely to be different; these facts may lead to the inference that the promoters recklessly disregarded the veracity of their profit estimates.

(c) Result

There is no result requirement for mail fraud. Thus, unlike most state fraud statutes, the mail fraud statute does not require the actual obtaining of property. Section 1341 requires that the schemer intend to execute a scheme or artifice to defraud, but it does not require that the scheme be completed or successfully carried out.[221] Section 1341 is intended to prevent misuse of the Postal Service,[222] and the offense is complete when the mails are used. Because completion or success of the scheme is not a part of the offense, a showing of actual damage or harm to the victim is unnecessary,[223] although it may indicate the defendant's state of mind.[224]

ii. Use of the Mails

The second element of mail fraud is use of the mails. The statute provides that anyone who "places in any

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[221] Blachly v. United States, 380 F.2d 665, 673 (5th Cir. 1967).

[222] See note 174 and accompanying text supra.

[223] Blachly v. United States, supra note 71; United States v. Andreadis, 366 F.2d 423, 431 (2d Cir. 1966), cert. denied, 385 U.S. 1001 (1967).

[224] See note 211 and accompanying text, supra.

post office or authorized depository . . ., or takes or receives therefrom . . ., or knowingly causes to be delivered by mail"[225] any matter for the purpose of executing a fraudulent scheme commits the offense of mail fraud. Each use of the mails is a separate offense.[226]

(A) Conduct

If the defendant himself, or his agent,[227] sends or receives material through the mail, he is chargeable under §1341. But it is only necessary that he "cause" the use of the mails.[228] In Pereira v. United States,[229] for example, a §1341 violation occurred where the sender and receiver were two banks, neither of which was a perpetrator of the scheme.[230]

The defendant's use of the mails must, however, be in execution or in furtherance of the scheme to defraud. The sequence of events and the closeness of the relationship between the mailing and the scheme determine whether this requirement is satisfied.

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[225] 18 U.S.C. § 1341 (1976).

[226] See Badders v. United States, 240 U.S.391, 394 (1916).

[227] United States v. Kenofskey, 243 U.S. 440, 443 (1917).

[228] As causation requires no act by the defendant, it is treated in these materials as a part of the state of mind for the offenses.

[229] 347 U.S. 1 (1954).

[230] Id. at 8-9.



In general, if the mailing occurs before the conception[231] or after the completion of the scheme,[232] the use of the mails is not in furtherance of the scheme.[233]

Hence in United States v. Maze,[234] the Court held that mailings of credit card invoices from the merchant to the credit company or from the company to the cardholder were not mailings in fortherance of a credit card swindle, even though the defendant caused the mailings.[235] The defendant had stolen the card and used it to pay for motel accommodations and restaurants. The Court held that the scheme was completed when the defendant checked out of the motel, having irrevocably received the fraudulently obtained goods and services. The subsequent mailings were for the purpose of adjusting the accounts among the defrauded parties and in no way affected the success of the

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[231] United States v. Beall, 126 F. Supp. 363, 365 (N.D. Cal. 1954).

[232] United States v. Maze, 414 U.S. 395, 402 (1974); Parr v. United States, 363 U.S. 370, 393 (1960); Kann v. United States, 323 U.S. 88, 94 (1944); cf. United States v. Wolf, 561 F.2d 1376-1380 (10th Cir. 1977) (mailings subsequent to defendant's sale of accounts receivable and receipt of payment were not in furtherance of scheme); United States v. West. 549 F.2d 545, 556 (8th Cir.) (phone calls subsequent to defendant's gaining physical possession of cattle through fraudulent means were not in furtherance of scheme), cert. denied, 430 U.S. 956 (1977).
The point at which the schemer obtains the fruits of his efforts is considered the completion of the scheme. United States v. Kenofskey, 243 U.S. 440, 443 (1917).

[233] Comment, "Survey of the Law of Mail Fraud," 1975 U. Ill. L.F. 237, 249.

[234] 414 U.S. 395 (1974).

[235] 414 U.S. at 399.

scheme. Because the use of the mails occurred after the scheme's fruition and had no relation to its success, it was not in furtherance of the swindle.[236]

Courts have created an exception to the general rule, however, for the mailing of lulling letters. Lulling letters are designed to convince the fraud victim that all is well and there is no cause for worry; they preserve or create the appearance of a legitimate transaction, thereby postponing inquiries and complaints and avoiding detection.[237] Such letters, even though mailed after the completion of the scheme, are considered to be in furtherance of it.[238] In United States v. Sampson,[239] for example, the defendants used lulling letters in the execution of an advance-fee racket. After obtaining a loan application form and a filing fee from each applicant, the defendants failed to carry out their promises to aid the applicants in obtaining loans.

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[236] 414 U.S. at 402. Compare United States v. Adamo, 534 F.2d 31 (3d Cir.), cert. denied, 429 U.S. 841 (1976) (merchants participating in credit card swindle; fruition when bank or credit company made payment in response to merchant's mailing of invoices; mailings in furtherance of scheme) with United States v. Maze, 414 U.S. 395 (1974).

[237] E.g., United States v. Sampson, 371 U.S. 75 (1962); United States v. McDonald, 576 F.2d 1350 (9th Cir.), cert. denied, 99 S. Ct. 105 (1978); cf. United States v. Staszcuk, 502 F.2d 875, 881 (7th Cir. 1974) (public hearing notices were not lulling letters because they were not used to conceal and continue a fraud), modified, 517 F.2d 53, cert. denied, 423 U.S. 837 (1975).

[238] United States v. Ashdown, 509 F.2d 793, 800 (5th Cir.), cert. denied, 423 U.S. 829 (1975).

[239] 371 U.S. 75 (1962).



The defendants mailed accepted applications and letters of assurance to the applicants to lull them into a false sense of security and to postpone complaints. The Court held that these mailings were in furtherance of the fraudulent scheme.[240]

The second component of the "in furtherance" requirement mandates that the mailing be "sufficiently closely related"[241] to the scheme.[242] This component is fulfilled when the mailing is "incident to an essential part of the scheme."[243] In Pereira the mailing of the $35,000 check from one bank to another was incident to an essential part of the scheme, namely, obtaining

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[240] Id. at 80-81. The Court also held that Parr and Kann did not set down an absolute rule that use of the mails after obtaining the fruits of the scheme can never be for the purpose of executing the scheme. 371 U.S. at 80.
This holding was reiterated in Ashdown, where the court states, "there is no rule that the money must change hands after the mailing."

[241] United States v. Maze, 414 U.S. 395, 399 (1974).

[242] Many courts have elaborated on the nature of the relationship between the mailing and the scheme. E.g., United States v. Brown, 583 F.2d 659, 668 (3d Cir. 1978), cert. denied, 99 S. Ct. 1217 (1979) ("if the mailing is a part of executing the fraud, or is closely related to the scheme, a mail fraud charge will lie"), United States v. LaFerrieu, 546 F.2d 182, 187 (5th Cir. 1977) ("the dependence in some way of the completion of the scheme or the prevention of its detection on the mailings in question"); Adams v. United States, 312 F.2d 137, 140 (5th Cir. 1963) ("significantly related to those operative facts making the fraud possible or constituting the fraud").

[243] Pereira v. United States, 347 U.S. 1, 8 (1954).

the money.[244] In general, the Pereira "incident to an essential element" test has been interpreted narrowly.[245]

Another description of the required relationship is that the use of the mails must be in furtherance of the scheme, not merely incidental or collateral to it.[246] To further the scheme, the mailing must aid it in some way. Furthermore, its purpose must not be at odds with the successful completion of the scheme.[247] Therefore, use of the mails that only increases the

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[244]The defendant had his wife sell some securities she possessed in Los Angeles. She received a $35,000 check from her L.A. broker and gave it to her husband, who endorsed it for collection to an El Paso bank. The check was mailed from Texas to California in the ordinary course of business. The check cleared, and a cashier's check for the amount was drawn in favor of the defendant, who absconded with the money.

[245]See United States v. LaFerrieu, 546 F.2d 182, 186 (5th Cir. 1977), where the court stated:

> The Court's language [in Pereira] does not mean . . . that a mailing somehow related to an aspect of the scheme brings the scheme within the scope of the mail fraud statute.

The court held that an attorney's letter on behalf of his client demanding verification that money deposited was still in escrow was not a necessary step in the scheme although it was somehow related to the post-fruition lulling element.

But see Ohrynowicz v. United States, 542 F.2d 715, 718 (7th Cir.), cert. denied, 429 U.S. 1027 (1976) (opening of checking account was essential part of scheme; mailing pursuant to ordering of personalized checks is in furtherance of scheme even though the defendant used only unpersonalized checks in the scheme).

[246]United States v. Edwards, 458 F.2d 875, 883 (5th Cir.), cert. denied, 409 U.S. 891 (1972); Adams v. United States, 312 F.2d 137, 139 (5th Cir. 1963).

[247]United States v. Staszcuk, 502 F.2d 875, 880 (7th Cir. 1974), modified, 517 F.2d 53, cert. denied, 423 U.S. 837 (1975). In Staszcuk, the scheme was to obtain approval of zoning amendments by means of bribery. The purpose of the mailing of public hearing notices was "to provide an opportunity for affected persons to state objections to the proposed zoning changes." Id. This purpose conflicted with the execution of the scheme.



likelihood of detection and apprehension is not within § 1341.[248]

Courts have also held that legally compelled mailings or routine mailings to carry out convenient procedures of a legitimate business are not in furtherance of a scheme, even though they may incidentally benefit it.[249] Innocent mailings are not rendered fraudulent merely because they occurred while a scheme was in progress.[250] Of course, if the routine mailing is a part of perpetrating the fraud, or is closely related to the scheme, it is within the mail fraud statute despite its secondary legitimate function.[251]

Other types of mailings held to be sufficiently closely related to the scheme include mailings that are products of

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[248]United States v. Maze, 414 U.S. 395, 403 (1974) (mailing of credit card invoices made detection more likely); United States v. LaFerrieu, 546 F.2d 182, 187 (5th Cir. 1977) (attorney's letter of complaint would "further detection of the fraud or . . . deter its continuation").

[249]Parr v. United States, 363 U.S. 370, 391 (1960) (legally compelled letters, tax statements, receipts, and checks are not within § 1341); United States v. Brown, 583 F.2d 659, 668 (3d Cir. 1978), cert. denied, 99 S. Ct. 1217 (1979) (business mailings in connection with obtaining a loan under false pretenses unrelated to the fraud).

In Brown, the court held that:

> A mailing . . . for the purpose of fulfilling a business of legal procedure unrelated to the fraud and . . . not closely connected with [it] . . . is too remote to convert a state law fraud into federal mail fraud, even though the mailing has the incidental effect of assisting the scheme.

[250]United States v. Tarnopol, 561 F.2d 466, 472 (3d Cir. 1977) (routing mailing of packing slips).

[251]United States v. Brown, 583 F.2d at 668 (request for wholesale financing as part of scheme to obtain new car inventory, sell cars for cash, and abscond with the cash under guise of robbery).

the scheme,[252] mailings incidentally informing co-schemers of the plan's progress,[253] and mailings of certificates or securities to the victim following a purchase.[254]

Mailings causing a delay necessary to the completion or continuation of a scheme are also in furtherance of the scheme.[255] Such mailings often are instrumental in the success of check-kiting schemes and credit card swindles.[256]

(B) State of Mind

The statute requires no particular state of mind to accompany a sending or receiving of mails. When the prosecution seeks to establish the conduct element by showing that the defendant "caused" the use of the mails, however, it must also demonstrate that he knowingly did so.

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[252] United States v. Hasenstab, 575 F.2d 1035, 1039 (2d Cir.), cert. denied, 99 S. Ct. 100 (1978) (mailing of requisitions closely connected with kickback scheme).

[253] United States v. Craig, 573 F.2d 455, 483 (7th Cir. 1977) (notcies of meetings informed co-schemers of the status of a bill; goal of scheme was passage of the bill).

[254] United States v. Tallant, 547 F.2d 1291, 1298 (5th Cir.), cert. denied, 434 U.S. 889 (1977) (mailing securities was integral part of scheme); United States v. Edwards, 458 F.2d 875, 883 (5th Cir.), cert. denied, 409 U.S. 891 (1972) (mailing of divorce decrees is final step in scheme).

[255] Cf. United States v. Maze, 414 U.S. 395, 403 (1974), where the Court rejected the contention that the delay caused by the mails was essential to continuation of the scheme by postponing its detection; the delay was due to distance, not to the mail service.

[256] E.g., United States v. Foshee, 569 F.2d 401, 406 (5th Cir. 1978); Williams v. United States, 278 F.2d 535, 538 (9th Cir. 1960); cf. United States v. Braunig, 553 F.2d 777, 781 (2d Cir.), cert. denied, 431 U.S. 959 (1977) (bank policy of crediting international checks to the account before confirmation from drawee bank allowed defendant to withdraw funds before discovery of forgery).



The courts' definition of causation renders this state of mind element relatively easy to prove. In Pereira, for example, the defendant had endorsed a check to a bank for collection. Since banks mail endorsed checks in the ordinary course of business, the Court reasoned, it was reasonably foreseeable that the endorsement would result in a use of the mails. The Court concluded that "where [use of the mails] can reasonably be foreseen, even though not actually intended, then [the defendant] 'causes' the mails to be used."[257] Similarly, some courts have held that use of a credit card resulting in the mailing of invoices from the merchant to the credit company or from the company to the cardholder also constitutes causing the use of the mails.[258] The mailings are reasonably foreseeable because they are the normal result of using a credit card. In short, section 1341 requires only that the defendant knowingly take some action which has the reasonably foreseeable result of a use of the mails.

The Rio Rancho fact pattern would probably provide many examples of uses of the mails or channels of interstate communication. An AMREP employee might well send a letter of solicitation or advertising brochure. The company might place an ad in

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[257] Id. at 8-9. The full definition of causation is as follows:

> Where one does an act with knowledge that the use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen, even though not actually intended, then he "causes" the mails to be used.

Id.

[258] United States v. Maze, 414 U.S. 395 (1974); United States v. Kelem, 416 F.2d 346 (9th Cir. 1969), cert. denied, 397 U.S. 952 (1970).

a newspaper delivered by mail, or accept a phone inquiry from a potential purchaser, or buy television time to promote the property. At the very least, each of these acts would "cause" such a use, under the broad judicial interpretations of sections 1341 and 1343.

2. Conspiracy

Section 371 of Title 18 prohibits a conspiracy "to commit any offense against the United States."[259] Conspiracy principles of liability apply to multi-member mail-fraud schemes, however, without regard to whether a conspiracy is charged.[260] Each participant is criminally liable for the reasonably foreseeable actions of his co-schemers in furtherance of the fraud, regardless of whether he knew of or agreed to those actions.[261] Once an agreement to participate in the scheme is established,[262] every member is responsible for acts within the general scope of the scheme,[263] including reasonably foreseeable mailings.[264]

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[259] 18 U.S.C. § 371 (1976).

[260] United States v. Joyce, 499 F.2d 9, 17 (7th Cir.), cert. denied, 419 U.S. 1031 (1974).

[261] See United States v. Craig, 573 F.2d 455, 483 (7th Cir. 1977), cert. denied, 99 S. Ct. 82 (1978); United States v. Wilson, 506 F.2d 1252, 1257 (7th Cir. 1974).

[262] Cf. United States v. Allied Asphalt Paving Co., 451 F. Supp. 804, 812 (N.D. Ill. 1978) (defendant must be party to scheme and must have specific intent to defraud).

[263] United States v. Cohen, 516 F.2d 1358, 1364 (8th Cir. 1975).

[264] United States v. McDonald, 576 F.2d 1350, 1360 (9th Cir.), cert. denied, 99 S. Ct. 105 (1978).



An affirmative act of withdrawal by the defendant will relieve him of liability.[265]

3. The Racketeer Influenced and Corrupt Organizations Act

The Racketeer Influenced and Corrupt Organizations Act[266] [hereinafter RICO] is a useful supplement to the mail and wire fraud statutes. RICO prohibits the running of an enterprise engaged in interstate commerce through a "pattern of racketeering activity."[267] A "pattern of racketeering activity" consists of at least two violations of certain designated offenses that are (a) committed within ten years of each other,[268] and (b) related to a common enterprise.[269] Mail and wire fraud are among the designated offenses.[270] The statute provides not only for criminal penalties[271] but for damages[272] and injunctive relief[273] as well.

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[265] United States v. Cohen, 516 F.2d 1358 (8th Cir. 1975).

[266] 18 U.S.C. §§ 1961-1968 (1976).

[267] Id. § 1962(c).

[268] Id. § 1961(5).

[269] See S. Rep. No. 617, 91st Cong., 1st Sess. 158 (1969); United States v. Elliot, 571 F.2d 880, 899 (5th Cir. 1978); Blakey and Goldstock, "On the Waterfront": RICO and Labor Racketeering, 17 Am. Crim. L. Rev. 341, 354-55.

[270] Id. § 1961(1).

[271] Id. § 1963.

[272] Id. § 1964(c).

[273] Id. § 1964(a).

a.Application: Rio Rancho Scheme

The early English jurists would not have found the Rio Rancho scheme worthy of criminal punishment. Common-law larceny required a trespassory taking, an element not satisfied here since the Rio Rancho purchasers handed over their money willingly. Even "larceny by trick" would not apply, inasmuch as the defrauders obtained title, not just possession.

The 1757 false pretenses statute and the Model Penal Code provision derived from it, however, would proscribe the venture. Like the defendants in Rex. v. Young, AMREP acquired title to property through oral misrepresentations. Under the Model Penal Code formulation, only the required showing that the defendants intended to mislead the victim would present any difficulties to the prosecution. But even this obstacle could be readily overcome by evidence that AMREP continued to predict large resale profits even after a study it had commissioned projected small market penetration.

Similarly, the federal mail and wire fraud statutes are broad enough to encompass the Rio Rancho scheme. Land sale schemes fall within the "scheme to defraud" requirement, and the Government can show intent to execute the scheme by introducing circumstantial evidence establishing the success of the scheme and the defendant's conduct in furtherance of it. Any use of solicitation letters or advertising brochures, or purchase of television time, would satisfy the "use of the mails or channels of interstate communication" requirement.

Finally, RICO should prove a particularly powerful weapon against defendants like AMREP. The prosecution should find it



relatively easy to obtain a conviction by proving two instances of mail or wire fraud within ten years of each other, and showing that the defendants conducted the business through such activity. Moreover, civil remedies may then be brought to bear. An injunction may be issued to halt the continuing fraud, or an individual purchaser injured by the fraud may recover treble damages.

b.Application: Arson-for-Profit.

Prosecutors, are also not without statutory authorities to effectively deal with the problem of arson-for-profit. To date they have used the criminal RICO statute, and the more traditional methods (mail fraud, etc.) with moderate degrees of success. It is clear, however, from the statistics that a more effective weapon is needed against the thriving arson-for-profit operations of organized crime groups. Simply stated, there are too many groups and members to prosecute successfully, and not enough resources or personnel in the law enforcement camp. As noted, the problems of proof in a criminal arson prosecution can be insurmountable. At the same time, the profit incentives of arson are too large for any unscrupulous group to ignore.

The civil (triple damages) provisions of RICO are ideally suited to the arson-for-profit problem. First, the statute is aimed at the heart of the problem -- the profit factor. Remove the enormous profit (indeed, any profit at all) and you have removed the threat of arson-for-profit. Here, the damages collectible from a defrauder are threefold the actual damages as well as the cost of suit and reasonable attorney's fees.

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The civil RICO provisions could thus eliminate the type of "arson empires" discussed earlier by depriving them of all available assets, legitimate or otherwise.

Like the other frauds discussed in this paper prevention of arson requires a commitment by all the parties directly or indirectly involved. The public can and has made a dent in the regional incidence of arson. Many state legislatures have responded to the privacy problem with immunity statutes and the community cost problem with statutes imposing liens on proceeds of fire insurance for outstanding taxes and demolition expenses. The insurance industry has begun to review their underwriting, valuation and adjustment procedures, inspect their properties, and cooperate with law enforcement officials.



V.

## CONCLUSION

When a round-the-clock professional police force to keep the peace in London was first proposed to Parliament in 1785, members denounced it as incompatible with the traditional liberties of Englishmen. Fourty-four years of general urban lawlessness later, the M.P.'s discovered that disorder was even more incompatible. Agreeing with Peel that "it was absolutely necessary to devise some means to give greater security to persons and property,"[274] Parliament then passed the Metropolitan Police Act, thereby validating the insight into genuine freedom proffered by R.H. Tawney: "It is still confidently asserted by the privileged classes that when the state holds its hand what remains as a result of that inaction is liberty. In reality, as far as the mass of mankind is concerned, what commonly remains is not liberty but tyranny."[275]

The intuition that state intervention can be the guarantor of personal freedom must be our guide in approaching the challenge of fraud, whether committed by white-collar crime, organized crime, or any other group or individual. Whether circumstances evoking application of the insight are present is a matter of fact, and the facts are: our post-industrial economy is rife with opportunities for illegal gain through deception; white-collar as well as organized crime offenders always are willing and able to exploit human and institutional

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[274] W. Lee, A History of Police in England, 245 (1971).

[275] B. Whitaker, The Police in Society, 14 (1979).

weaknesses; our criminal justice system, already overburdened with the task of preserving physical security in the streets, is simply incapable, as presently constituted, of effectively policing the marketplace; and finally, with a constantly eroding moral order, there is little prospect of society policing itself.

What are the alternatives? Short of the moral reconstruction of society, we must, if we are serious about combatting the fraudulent activities of white-collar or organized crime offenders, be open to the use of innovative law enforcement techniques -- like RICO and the creation of special prosecutors and Inspectors General offices. We must turn our attention, too, to efforts to get law enforcement as organized as organized crime and white-collar offenders. As Edmund Burke said, "the only thing necessary for the triumph of evil is for good men to do nothing."[276]

[276]Letter of Edmund Burke to William Smith, January 9, 1795.



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