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Written Testimony for

Special Committee on the Aging

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TABLE OF CONTENTS

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Dear Senator Kohl, Mr. Chairman and other members of the committee:

It is a real honor to be able to appear before this committee. It is not everyday that we convicted felons get a chance like this so I hope I do not waste this opportunity. I do not think you need someone like me to give the committee a whole lot of statistics on financial fraud and its impact on the elderly. There are those that are far better equipped and educated to provide that kind of data. I would rather focus on what I can uniquely bring to the discussion based on my past and current experiences in fraud perpetration (much to my shame) and now in fraud detection. So I will open with a few facts about fraud.

Facts about Fraud

First, let me define what I mean by the term "fraud." In the world of fraud perpetration it is not a legal definition but a pragmatic one. Fraud is the skin of the truth stuffed with a lie. This is why it is hard for the elderly and other investors to identify it. By this definition I mean that in my fraud, we really did have 23 locations, lots of carpet cleaning trucks and equipment and 1,400 employees. And if you called any of those offices we would be there to clean carpets and furniture so on the surface "skin" we looked good. However, the "stuffed with a lie" part of the ZZZZ Best fraud was the restoration jobs that we claimed to be completing which accounted for 86% of our revenues. Those restoration jobs never existed. Successful education to the elderly in the area of financial fraud prevention must equip people to peal away the mask (skin) and look underneath (the stuffed with a lie component).

Second, let me explain why we who perpetrate fraud actually perpetrate fraud. Forgive the simplicity of this answer but we perpetrate fraud because we do not think we are perpetrating fraud. Sure it is illegal to lie about earnings, hide debt and promise returns that are extraordinary but if you just knew our story and that we have a big deal coming that will provide enough revenues to "cure" our indebtedness, then you would realize that fraud is not an end in itself but merely a means to an end. A "means" we willingly justify.

Whether you look at my case where I tried to survive long enough until my personal ZZZZ Best stock became free trading so I could sell a million shares at 18 dollars a share,

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and with the proceeds pay off the mafia, pay off the Ponzi scheme and go legitimate or the case of Martin L. Grass from Rite Aid who "got dirty with the books" because he was opening 3,000 new stores and ran into computer integration problems and knew the stores would eventually make money so he lied to the auditors "temporarily" until those stores became profitable, we who perpetrate fraud convince ourselves that we really are not crooks. That way we can sleep at night knowing our condition of deceit is only temporary.

In the case of James Lewis of Financial Advisory Consultants which ended up being the largest and longest running Ponzi scheme in American business history (almost 20 years) he lost 20 million of investor money in high risk foreign currency trades hoping to "hit it big" and pay everyone back or cure his liabilities. The same was true in the case of Nick Leeson while he was trading at Barings PLC in England. A 223-year-old bank lost a billion dollars and went under all because Mr. Lesson continued to hide trading losses hoping to recoup those losses with even riskier trades.[1] My point is that we rationalize our criminal behavior to appease our conscious through the mental vehicle of "the cure."

Fact number three, we usually start out with the best of intentions. Of course this does not justify our actions but I did not open a carpet cleaning company in my parent's garage when I was 16 years old to end up committing a 26 million dollar securities fraud by the time I was 21. Admittedly the FBI may disagree with me on this issue as it has come up before in my training sessions (they believe certain people start out from the beginning to perpetrate fraud) and I concede that this may be true but for the majority of frauds that I have been involved in uncovering and from the people I spoke with in prison during my 87 month incarceration, most appear to have started out with the best of intentions and then when economic pressure hit to survive they began a life of deceit. In my case, I initially really wanted to do what was right, but was sadly prepared to do what was wrong to survive.

I call it the "right equals forward motion" ethic. "Right" being defined as achievement at any cost and "wrong" being defined as any auditor, board member or person performing due diligence on me who gets in the way of my achieving. Sadly it would appear that the "right equals forward motion" is the ethic appealed to by every college person who cheats their way through school because they have become convinced that society judges them based on achievement (the degree) not how they earned that degree (perhaps cheating along the way). This "right equals forward motion" ethic was the one I implemented at ZZZZ Best.

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[1] I think the movie *Rouge Trader* did a good job of capturing this fact in the Nick Leeson story.

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What Perpetrators of Fraud Fear the Most

Now let me transition to what perpetrators of fraud fear the most. Three things come to mind. First, we fear the unknown variable. The "unknown variable" is that thing that we cannot control or anticipate that ends up exposing our illegal activities. The unknown variable ranges from a falling out among thieves where one turns on another or a sudden, unexpected drop in sales or the one that brought down the ZZZZ Best fraud—investigative reporting. No perpetrator of fraud wants to be the target of a reporter who is investigating their business dealings. At ZZZZ Best it was a diligent writer from the *Los Angeles Times* that found out about my past fraudulent credit card billings and wrote an article that prompted further investigation of my operations. Another recent example would be the case of Congressman Randy "Duke" Cunningham whose house sale and subsequent questionable activities were first reported by the *San Diego Union Tribune*, which led to further investigation. The media is a powerful, proactive tool that can help protect the elderly from fraud because those who perpetrate fraud fear that if undue attention is brought to their activities, someone may uncover what "we" are trying to hide that could unravel our fraudulent activities.

There is one very recent example of the proactive power of investigative reporting in uncovering fraud. In February of 2006, Mark Maremont, a reporter from the *Wall Street Journal* decided to run a story on the Internet "autosurf" industry. I first contacted Mr. Maremont in January of 2006 and told him about this industry and a certain company we were gathering information about for the FBI, which was also turned over to the SEC in Los Angeles. I subsequently forwarded a copy of our completed report on January 31, 2006.[2]

It did not take long for Mr. Maremont to establish that the one company that we were investigating had 300,000 participants and had raised over 50 million dollars. Mr. Maremont wrote his initial article on February 13, 2006 and within two weeks Peter Delgreco at the SEC in Los Angeles shut down this company, froze some 50 million dollars in cash for victim recovery and then issued a formal warning on the autosurf industry to protect the public in the future.

My point is that we who perpetrate fraud do not want to be the target of investigative reporting. However and sadly, fewer and fewer reporters have time to do investigative reporting. Things have changed since the ZZZZ Best days. It would appear that today editors of major newspapers and magazines are far more interested in simply reporting what has already happened as opposed to uncovering ongoing fraud. However, there are

[2] Before too much credit is given to me for this case, it should be stated that many people were skeptical about this industry before our involvement.

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some that still do investigative reporting and they are worth noting for the record because they have track records of saving the elderly and other investors millions of dollars.

Don Thompson at the *Associated Press* in Sacramento has done almost seven of our cases before there was law enforcement action. Scott Reckard at the *LA Times* still does this type of reporting as does Mark Maremont and Jeff Opdyke at the *Wall Street Journal*. And there are others. I realize that it is impossible to legislate the media to do this kind of reporting. However, I cannot ignore how important it is to encourage editors around the country that there is value in allocating resources to investigative reporting on the various scams that target the elderly and others.

The second thing perpetrators fear is critical thinking. We want people to make investment decisions into our "deals" subjectively rather than objectively. Three examples of the subjective approach are: (1) a close friend or relative has been receiving large returns monthly for extended periods of time therefore this investment must be legitimate or (2) the prospective investor has little to no knowledge of the industry they are contemplating an investment in and therefore do not possess the knowledge to ask the right critical, objective questions about the business model. This leaves them at the mercy of the warrants and representations of the promoter and finally (3) the blind and unsubstantiated acceptance of excessive returns because the perpetrator has successfully compared his or her potential returns with the current, underachieving returns of the victim.

My experience as a perpetrator and in the 15 or so cases of fraud we have worked proactively with law enforcement to uncover has taught me the importance of the objective approach to investment using what I call the "normally and regularly test." That means instead of basing a decision to invest based on my friend's experiences no matter how positive they may be, investors need to ask the following question: "Normally and regularly do people in the carpet cleaning industry generate 40% gross profit margins in the restoration business?" Or, "Normally and regularly do people in the factoring business have the profit margins available in that industry to pay investors 30% a year as a cost of capital?" The point is that when investors approach an opportunity, decisions to invest must be made objectively while applying critical thinking. And we who perpetrate fraud cannot stand people who apply critical thinking to our deals and often revert back to tactics like: "Well, I've got a lot of happy investors so your loss."

The issue is not happy investors. I had happy investors at ZZZZ Best. Most Ponzi schemes and fraudulent deals can point to happy investors. The issue is: does the business model hold up to the objective scrutiny applying critical thinking. Despite this being obvious in every fraud we have uncovered, investors have threatened me with lawsuits, called me an "ex-con who did not know business" or "jealous because I wasn't able to run a profitable company." Fortunately in just about every one of our cases the

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perpetrators eventually admitted guilt. The point? People hold onto the subjective method of investment methodology until the very end, despite what the objective evidence may reveal, which leads to the lack of independent proof of profitability.[3]

Investors subjectively accept the word of the promoter as it relates to his or her ability to generate huge returns without those returns being corroborated by any independent source. This was clearly prevalent in the Derek Turner Turning International fraud (he was recently sentenced to 20 years in federal prison). Mr. Turner claimed to be generating 38% annual returns trading stocks and options each year for nine straight years. The only problem was that he refused to provide investors with trading records to corroborate his trading success. He also did not offer investors any audited financial statements. However, that did not stop Mr. Turner from raising between 60 and 80 million dollars worldwide because people used the subjective method of evaluating his company. And yes, Mr. Turner had elderly victims including one man from New York who lost $1,000,000 in Turning International.[4]

The third thing perpetrators fear is accountability. Consider the following points of similarity in the following cases: MX Factors, LLC run by Richard Harkless; Financial Solutions run by Chris Hashimoto; Financial Advisory Consultants run by James Lewis; Chicago Development and Planning run by Pat Morgen; Turning International run by Derek Turner; Par Three Financial; Rainmaker Real Estate run by Alireza Dilmaghani; and Ware Enterprises run by Warren Ware—all of these multi-million dollar companies had no audited financial statements, were largely 'one man shows' and had no system of internal controls which would discourage illegal activities. Now of course the presence of audited financial statements does not necessarily prove financial accuracy (Enron, WorldCom, etc.) but the absence of audited financial statements in companies that lack independent proof of profitability is clearly a red flag for fraud. In the above mentioned cases the standard answer that was given when the perpetrator was asked for audited financial statements was, "We are a private company and are therefore not required to provide financial statements."

Again, the points of similarity are (1) unsubstantiated returns (no independent proof of profitability), (2) organizations dominated by a single person who was accountable to no

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[3] In the case of the elderly, the promoter will often befriend and charm the individual and provide the attention that is perhaps lacking in their life hoping that the subjective relationship will blind the elderly investor of the truth about the investment.

[4] It should be noted that in the case of Derek Turner, Special Agent Matt Galioto from the Long Island office of the FBI did an incredible job getting this company shut down in an 18-month investigation. The challenge in this case was Mr. Turner set up shop in the Bahamas but regularly solicited American investment capital. Matt Galioto and I traveled to the Bahamas using me as an undercover potential investor to secure the evidence needed to shut down this operation. Mr. Galioto was also the lead agent in the Rainmaker Real Estate fraud.

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one and (3) the promoter's reliance on potential investors subjectively analyzing their business models as opposed to applying critical and objective thinking.

The Latest Twists Perpetrators are Using Against the Elderly

The three things I fear the most as it relates to the elderly and investment fraud are (1) what I call the new emphasis on attracting retirement money or qualified money by perpetrators from investors and (2) the rush offshore to stay out of the reach and jurisdiction of law enforcement and (3) the huge increase in unregistered securities fraud.

Those of us who perpetrate fraud must continue to raise money to keep the scheme going. It is for this reason that most Ponzi schemes or investment frauds collapse from the sheer weight of paying those high returns. However, the new trend that I have seen which is an attempt by perpetrators to overcome this obstacle is is the latest emphasis on attracting qualified retirement money from the elderly or from the general public. Why? In the ZZZZ Best fraud, I had to pay out high returns monthly and sometimes weekly which is a cash flow drain and always forced me to raise new investor money to pay off old investor debt.

However by convincing investors to use their retirement accounts to invest in these "deals," the perpetrator only needs to come up with monthly statements showing certain achieved returns rather than the actual cash because normally people cannot withdraw cash from retirement accounts before age 57 1/2 without a severe penalty. In the case of the elderly, they are told that without investing their retirement funds in "this deal" they may "outlive their retirement."[5] Moreover, by accepting retirement money perpetrators impute credibility to their investment opportunity because there is an implied credibility associated with being an "IRS approved retirement investment." The implication is that before a company can accept retirement money from investors the IRS "checks them out." However, the reality is the IRS does not perform any due diligence on the authenticity of an investment opportunity and as long as there is an authorized custodian of transfer the legal burden for accepting qualified money has been met.

[5] It should be stated that with the extra time provided the perpetrator through retirement money the perpetrator has more time to figure out the "cure" or create a vehicle to earn enough money to pay off investors (please see "why we who perpetrate fraud perpetrate fraud").

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Several of the cases we have worked on have had this acceptance of qualified money component. Financial Advisory Consultants, Triple Crown Enterprises and Par Three Financial just to name a few… and the trend appears to be increasing. The reason is because it solves many of the perpetrators' problems in that it imputes credibility to the investment and lessons the pressure to meet monthly or annual payment of investor returns.

My second fear is the move offshore with many investment opportunities. As has been stated earlier, Derek Turner intentionally used the Bahamas as his base of operation and yet focused much of his attention on American investors. Much of the "autosurf" industry has their operations in Belize or the Cayman Islands. Bogus tax shelters that target the elderly and young alike are often offshore. The appeal to the perpetrator is obvious: reach people in the US through the anonymity of the Internet or other means like ads in newspapers and magazines as well as word of mouth and avoid the scrutiny and accountability of US registration requirements. It is critical that law enforcement continues to send a message to these types of perpetrators like the one sent by the FBI in the Turning International case. Even those who perpetrate fraud offshore need to be on notice that they can and will be prosecuted.

Thirdly, it would appear that investment fraud costs the American public about 40 billion annually[6] and much of that figure comes from a certain type of fraud—specifically unregistered securities fraud. In short, the elderly and the average American investor do not know the definition of a security and because of that are not able to recognize an unregistered security. Simply put, a security is not a stock or bond like most assume. An investment is a security whenever I (the promoter) take someone's money, promise them certain returns and invest that money in widgets, carpets or foreign currency trading—it does not matter.

What the elderly and others need to know is that a security does not have to be a stock or bond in order to have the licensing requirements that require said offerings to be sold only by licensed broker dealers and to have those offerings registered or blue skied in each state they are sold in. Out of the 15 cases we have been involved in uncovering with law enforcement, almost every one of them was deemed an unregistered security being offered by unlicensed broker dealers. Raising awareness in this one area about what constitutes a security under the definition of the law may go a long way in protecting the elderly. Why? Because where there is an unregistered security, there is most likely fraud

[6] Please see email from Bernie Bicoy to me. Mr. Bicoy is the founder of the Venture Research Institute in Orange County, California and is a recognized expert in the field of investment fraud. Frankly he is a lot more educated about fraud than I am and I respect his views greatly. His email to me also includes some additional helpful insight regarding fraud against the elderly and how they are perceived as easy targets.

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and misrepresentation. But as of right now, I am afraid that few investors, especially the elderly, can identify an unregistered security.

My Recommendations

The best way to stop fraud is to talk people out of ever perpetrating it in the first place. This may sound naïve, but I am convinced that the two most important things to detour fraud—especially against the elderly—are to increase the perception of detection and the perception of prosecution. In my opinion the best-equipped agency to criminally investigate white-collar crime on a national level is the FBI. No other organization is even close. And I can speak from first hand experience about their ability to piece together sophisticated white-collar crime.

However, since the tragedy of 9-11-2001, a large part of the FBI resources have rightfully been committed to terrorism. My fear is that one of the reasons why financial crimes appear to have increased in the US over the past few years can be attributed to the fact that perpetrators think the FBI is too preoccupied with terrorism to devote the resources necessary to catch them. And when the perception of detection is low, perpetration increases. If I am convinced that there is a high likelihood that I can get away with a financial fraud I may be more inclined to perpetrate one.

The Senate and the Congress know this all too well because if Sarbanes-Oxley did anything it increased the perception of detection for CEOs and CFOs who may have had the inclination to cook the books in a public company before this law was passed. But what about the other 40 billion a year in investment fraud that is not under the jurisdiction of Sarbanes-Oxley? My recommendation would be to increase the FBI's budget so that they would be able to allocate more resources (agents) to white-collar crime. Besides, as we all have learned, behind every terrorist act there is a white-collar crime. My point is that I think that in order to increase the perception of detection, the FBI needs more agents working on bringing perpetrators to justice.

I have heard it said that for every one IRS criminal agent that is hired, on average that agent recovers four times the amount of his or her salary in tax fraud. I do not know the exact figure for the FBI as it relates to the monetary value of each new agent assigned to white-collar crime, but if you want my opinion from my experience in perpetrating and uncovering financial fraud, each new FBI agent assigned to investment fraud would recover at least ten times their salary in either seizures or court ordered restitution, all of which now go back to the victims of the crimes. And for the elderly that is critical.

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I would make the same recommendation for the Securities and Exchange Commission as it relates to an increase in staff designated for these types of frauds. Although primarily a civil enforcement agency, they have had tremendous success shutting down financial crimes in progress and helping victims receive recovery.[7] The only problem I see is that some of the people the SEC shut down may surface again as a promoter of a new crime if not followed up by criminal prosecution (a referral made to the FBI).

This is exactly what happened in the Edward Showalter case. Mr. Showalter had two separate run-ins with the SEC in Washington and Los Angeles before he perpetrated a 20 million dollar real estate fraud involving hundreds of people and was sued once again by the SEC in November of 2005. The difference this time was the FBI in Santa Ana was brought in and special agent Peter Norell made sure that Mr. Showalter was criminally prosecuted and therefore will not be a repeat offender.

To assure that others like Showalter do not slip through the cracks, an intentional working relationship between the SEC and the FBI needs to be established.[8] Take it from me, the only thing we criminals fear is criminal prosecution and jail—not fines or bans from the SEC.[9] When the SEC files a lawsuit for fraud everything necessary for criminal prosecution is included in the great work they have already done. The investigative "heavy lifting" is complete and included in the court filing made by the SEC. Once a TRO is attained in federal court and a receiver assigned, fraud and misrepresentation has been proven. It is low hanging fruit for the FBI and the SEC should intentionally refer these cases to their local FBI office for follow up criminal prosecution. This will aid in increasing the perception of prosecution.

Another recommendation would be creative and innovative educational tools, which are helpful in protecting the elderly from fraud. Please forgive the shameless plug but we are in the process of creating DVDs targeting the children of the elderly (for the most part, everyone has a mom and dad that they care about) in hopes of the children taking the lead in protecting their parents from fraud. These DVDs will be creative in their presentation and identify the "top 10 frauds" that specifically target the elderly. Of course, others have similar tools that are equally effective including law enforcement agencies like the California State Attorney General's office.[10]

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[7] In addition to, of course, their regulation of public companies.
[8] Of course these two agencies have had several successful joint investigations. However, I am referring to the many cases the SEC investigates and sues without FBI involvement.
[9] By making this statement I am not depreciating the significance of their work but am merely stating that they are limited to civil enforcement.
[10] I was actually honored to be able to appear in this video project designed specifically to educate and protect the elderly.

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Another suggestion would be that law enforcement nationwide changes their approach as it relates to financial fraud investigations. In many instances, law enforcement will not investigate a crime until there is a complaining victim. This outdated methodology helps criminals. Why? Because as a perpetrator of fraud I know I must keep investors in my scheme happy by paying them on time so they will help recruit new investors into my deal and to prevent them from going to law enforcement. We keep this façade going until things fall apart and the fraud collapses.

Most law enforcement agencies will not even entertain opening an investigation on a company that has no victim complaint of a large, monetary loss and this approach plays into the hand of perpetrators. Law enforcement nationwide should examine the work of Karen Patterson at the California Department of Corporation, Peter Delgreco at the Securities and Exchange Commission in Los Angeles and Special Agents Peter Norell and Matt Galioto of the FBI as examples of successful prosecution based on probable cause as opposed to waiting for the fraud to collapse and victims to complain.[11]

The probable cause test cares nothing about whether or not people are "receiving their promised returns" but instead focuses on objective tests like sources and uses of cash, whether or not an unregistered security is being offered and the tenability of the business model. The success the abovementioned law enforcement officials have in proactively uncovering fraud *before* the company in question collapsed and while there was still money to seize and return to victims is hard to argue against.[12]

My final suggestion, which would require minimal work and expense, is to reinforce investigative reporting when it works in protecting the public. Senators and members of Congress can simply jot a quick note to the editor or writer of the publication that breaks stories that protect the public from an ongoing fraud. Maybe then more editors will see the value of the "unknown variable" and how their unique position in the media can save the elderly from being targeted.

As I mentioned earlier, people like Don Thompson at the *Associated Press*, Scott Reckard at the *Los Angeles Times*, and Jeff Opdyke and Mark Maremont at the *Wall Street Journal* have long track records of proactive fraud pieces that have taken the public out of harm's way through accurate, investigative reporting. Believe me, no perpetrator wants newspapers and magazines focusing on investigative reporting.

[11] I am sure others in law enforcement take this proactive approach, but not many in my experience. Frauds we have uncovered have brought us to many states where law enforcement officials stated things like, "Bring me a victim and we will take a look."

[12] Of course, these law enforcement officials have worked cases that I have not been involved with and achieved the same result.

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Conclusion

Let me close by reminding the committee that I apologize if my testimony has come across like I am some kind of "know it all." I am not and if it has come across that way I ask in advance for your forgiveness. As I always tell my church congregation, I am a liar and a thief saved by the grace of God. I never lose sight of the fact that I have been given another chance in this life—one that I do not deserve. Today, I do not commit securities fraud but I still have a long way to go in becoming a better person. Just ask my wife or any elder at the church that I have pastored for over nine years.

I would also say that there are many others who have come out of prison that have far outperformed me in their contribution to society. That you would even entertain the testimony of someone like me is a privilege that I do not merit. However, I love this country and consider it an honor to help in any way you deem necessary to protect people—especially the elderly from financial ruin.

Respectfully submitted,

Barry Minkow