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Part III: Bankruptcy Frauds

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POLICE SCIENCE



CALVIN GODDARD [Ed.]

ORGANIZED PROTECTION AGAINST ORGANIZED PREDATORY CRIMES¹

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III. BANKRUPTCY FRAUDS.

1. The Bankruptcy Laws of the United States are provided for in Article I, section 8 of the Constitution, which conferred authority upon Congress to pass uniform bankruptcy legislation. The legislation passed in accordance with this provision, confers exclusive jurisdiction upon the United States District Courts in bankruptcy proceedings. It should not be inferred from this that all insolvency litigation is carried on in Federal courts, for the reason that until a petition has been filed in an individual case in a Federal Court, the law of the State applies. Many insolvency proceedings are started under State laws and the Federal Government has no jurisdiction in these proceedings until some provision of the National Bankruptcy Act and Amendments is invoked.

Notwithstanding the volume of insolvency litigation which occurs in State courts, a very large volume of business of this character is also transacted yearly in Federal courts. The number of cases increased from 15,000 in 1921 to 60,000 in 1931. The indebtedness involved in these cases in the corresponding period increased from one hundred seventy-one million dollars to one billion eight million

¹Former articles in this series dealt with: I. Bank Robberies; II. Automobile Thefts (JOURNAL, Jan.-Feb. 1933).

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dollars. The dividends paid in the same period increased from twenty-one million dollars to sixty-six million dollars. These figures, which are quoted from the report of the Attorney General to the President, dated December 5, 1931, also indicate that the percentage paid to general creditors decreased from 7.7% in 1923 to 5.1% in 1931.

The term "bankruptcy frauds" is used in this article to indicate the violations of Federal law which occur in connection with these cases. Section 29(b) of the National Bankruptcy Act and sections of the Criminal Code of the United States, outline a number of offenses applicable in bankruptcy cases. These statutes which refer to violations such as concealment of assets, false oaths, false accounts, falsification of books and records, embezzlement, and certain other actions considered criminal, are designed to prohibit and punish the defrauding of creditors through the concealment of assets which should be distributed in the form of dividends through the Bankruptcy Courts. In addition to these crimes, the laws define concealment of assets, as well as concealment or destruction of books and records in contemplation of bankruptcy. The provisions penalizing acts designed to defraud creditors before the bankruptcy petition has been filed or Court proceedings have been instituted, have, for the greater part, been added in amendments to the Bankruptcy Laws, passed in 1926.

The procedure involved in the foregoing classes of cases is distinctively Federal, inasmuch as the basis therefor is provided by the Constitution, and the duty of securing evidence for use in prosecutive action by United States attorneys devolves entirely upon the United States Bureau of Investigation. The investigative staff of this Bureau is fully qualified for inquiry into bankruptcy frauds, inasmuch as all special agents coming within the jurisdiction of this Bureau must be either lawyers or graduate accountants with experience in investigative work. These men are given special training at the time of entry into the service in methods of investigation most adaptable to bankruptcy; this training is continued after assignment to field offices. Bankruptcy investigations, as well as other types of criminal investigative activity, receive the supervision of experts in this particular field located in Washington, all reports being carefully scrutinized in order to insure the employment of the latest, most scientifically comprehensive methods, and in order that all investigations warranting such action may receive most thorough inquiry.

2. As a rule, more than one person is involved in a fraudulent

bankruptcy. At times more than one bankruptcy is included in a single criminal case and the activities of a "gang" engaging in bankruptcy violations professionally or through organized methods, are prosecuted in a single criminal action, in order that one jury and one judge may be afforded an opportunity to pass upon the general methods and course of conduct engaged in by this "gang," and thereby be enabled to more adequately consider their guilt or innocence and the punishment which should be inflicted in the event of the former.

An accurate idea of the extent of bankruptcy violations may be secured from the report of the United States Bureau of Investigation, which for the fiscal year 1932, ending June 30, 1932, indicates that there were 182 convictions in bankruptcy cases and sentences imposed totalling 123 years, 4 months and 17 days, in addition to 40 years, 9 months and 12 days suspended sentences, and 121 years probationary sentences. This report indicates that in the course of these investigations by Special Agents of the United States Bureau of Investigation, actual recoveries of assets amounting to \$111,009.68 were accomplished, this property being turned over to Bankruptcy Court officials for distribution to creditors. There is no way in which the amount of assets returned to creditors voluntarily, as restitution because of criminal prosecutions, may be judged or even inferred, inasmuch as the criminal statutes do not permit cognizance to be taken of such restitution as a means of escaping or modifying punishment. The report of the United States Bureau of Investigation also indicates that \$41,809.11 in fines was imposed. It should be remembered in this connection that the criminal provisions of the Bankruptcy Act do not provide for the imposition of fines. The figures in question, therefore, are manifestly those involved in the invoking of punishment for perjury or conspiracy under the Criminal Code, or the use of the mails to defraud.

There is some popular misconception of the extent of organizations engaged in crimes of this character. There are indeed instances involving the operations of "gangs" or organizations of professional criminals engaged in violations of the Bankruptcy Act. But the most usual type of case is that in which the bankrupt, assisted perhaps by friends or relatives, endeavors to save for himself, at the expense of creditors, some portion of his assets.

A typical case involving an organization of criminals involved in crimes of this character is an assignment recently concluded by special agents of the United States Bureau of Investigation at New York City, wherein twelve defendants were convicted of concealing

assets in bankruptcy, and conspiracy. This was in connection with the bankruptcy of the H. J. Sherman Company of New York City. For more than two and one-half years this group of professional commercial criminals engineered eight fraudulent bankruptcies in New York City and vicinity. They succeeded in mulcting packers, wholesale grocers, and affiliated merchants of merchandise the retail value of which is estimated at three-quarters of a million dollars. The investigation by the special agents of the Bureau extended over a period of one year. The ringleader was found to be one Minos K. Ziongas. He was assisted by his brother Pericles, Elkan B. Marks, Theodore D. Berman and Sidney T. Dobbs. A deliberate scheme was concocted by these individuals to obtain control of certain companies, in order that having obtained such control, they would be better enabled to defraud the creditors. The firms involved in all instances were those possessing a good credit rating. The first operation contemplated the further building up of this credit by prompt cash payment for purchases, until creditors were lulled into a complete sense of security. When this was accomplished, extremely large orders for any kind of merchandise whatsoever would be placed on credit. As soon as the merchandise was received, it would be diverted to certain of the conspirators who distributed it among dealers in such manner as to obtain cash therefor at a considerable discount from cost price. The money was then hidden. By the time creditors realized that payments were not being made, the firms were thrown into bankruptcy and the conspirators proceeded to a new location for a further trial of the same or similar scheme. The names of the firms used in the course of this scheme will give an idea of its extent. These were the Long Island Paper and Grocery Company, which went into bankruptcy in 1929, the Interstate Sales Company, the Puritan Products Company, the Mercer Merchandise Company, Inc., the Tri-County Grocery Company, Inc., the Euro American Corporation, and the H. J. Sherman Company. Fictitious names were used by the conspirators, and it was with considerable difficulty that their connections with the individual bankruptcies were proven. Elkan B. Marks was not apprehended until April 26, 1932. Notwithstanding that Pericles Ziongas and Theodore D. Berman had been arrested in the latter part of 1930, they continued their activities while at liberty under bail awaiting trial, in connection with other conspirators in bringing about other fraudulent bankruptcies. Six individuals involved in this conspiracy entered pleas of guilty and testified for the government. Three stood trial and were convicted, two receiving sentences of five years each

and one, two years. To indicate the ramifications of this conspiracy, it should be noted that some twenty-four persons were indicted and only two acquitted.

An interesting incident arising from the investigation of this case consists of a suggestion to special agents of the United States Bureau of Investigation, by several of the principal figures in this conspiracy, that in order to prevent commercial frauds consideration should be given to a modern method employed by professional criminals to effect their ends. This method involves the ascertaining of the financial standing of a firm whose trade name is registered in an adjoining county. If the condition is satisfactory, that trade name is adopted by the criminals and a certificate filed to do business in the county in which the criminals expect to operate. Merchandise will then be ordered, and the creditors, upon looking up the name of the firm in the rating books, will find that said firm has a satisfactory financial rating and credit will be granted. The creditors, of course, in so doing, will act upon the assumption that they are shipping their goods to the regularly established firm.

The United States Bureau of Investigation also makes inquiry during the course of each year into cases in which allegations are made that a trustee, receiver, referee or other official of the Bankruptcy Court has been guilty of irregularities. These cases, it is true, are but few in number, but several prosecutions have occurred.

Another type of violation to be noted is that involving organized groups of auctioneers and dealers in merchandise who in various localities have been found upon occasions to control the bidding at Bankruptcy Court auction sales. This organized control of what would otherwise be competitive bidding is of extremely ancient lineage. It seems to have occurred in various foreign countries, as well as the United States, from time to time as far back as records may be found. It consists in a mutual agreement among persons who deal in cut-rate merchandise as brokers, or otherwise, to permit sham bidding, and arrange so that one of the group may be the successful bidder, purchasing the goods in question at a fraction of their forced sale value. A second sale is then held by the conspirators, and the difference in the price obtained at the second sale and that paid at the sale conducted by the Bankruptcy Court officials is divided among the conspirators. Among the more prominent of the "gangs" engaged in these practices is one known as the "Forty Thieves," which operated successfully for a long period. Manifestly, it is extremely difficult to obtain evidence of violations of this type. As a general rule

all of the conspirators are well known to one another, have been acquainted for years, and the difficulties involved in securing evidence of conspiracies are at times almost insuperable.

The United States Bureau of Investigation maintains very close contact with persons in a position to report possible violations of the Bankruptcy Laws, in order that it may receive prompt advice of the commission of these crimes and in order that it may keep in close touch with general conditions. These contacts include, among others, commercial organizations, credit agencies, and similar groups, some of which have, in the past, maintained investigative staffs for the purpose of investigating credit conditions. Through the cooperation secured from such organizations, the United States Bureau of Investigation has been able to maintain valuable contacts and pursue its investigative work with a view to securing convictions of individual criminals and organized conspirators without a considerable expenditure of time and money.

3. The provisions of the National Bankruptcy Act of 1898 and Amendments, designed to safeguard the interests of creditors, have not in practice always been found satisfactory to those interested in these proceedings. Complaints that the bankrupt has been favored, and that the administration of bankruptcy estates has been too expensive in proportion to the assets distributed to creditors, were made from time to time. This has resulted in recent years in two investigations of bankruptcy conditions which may be termed general in scope.

The first of these was in the Southern Judicial District of New York which covers the Borough of Manhattan in New York City. It was instituted by the United States Attorney, who was joined by a committee of the local Bar Association and interested organizations, such as the National Association of Credit Men. The United States Bureau of Investigation assigned numerous Special Agents to this inquiry. On various other occasions similar investigations have been made in other districts by Special Agents of the Bureau. It should be noted that investigations of this kind differ from those ordinarily made, since these inquiries are for the purpose of determining first, whether a clique or group of attorneys or others has been enjoying a monopoly by means of which it is enabled to manipulate bankruptcy proceedings for its own benefit; second, to determine whether administrative abuses or inefficiencies exist which may be remedied by the adoption of additional Court rules or similar procedure.

Following the investigation in New York City, the Attorney

General, in 1930, was directed by the President to inquire into the entire question of bankruptcy law and practice. Transmitting his report to the President in 1931, the Attorney General stated that this inquiry had been conducted in cooperation with the Department of Commerce and with the assistance of many business organizations, court officials and others. A report was then made which was transmitted to Congress and which proposed certain definite changes in several features of the law, among which was one providing for additional officers to examine more closely the conduct of bankruptcy cases in order to eliminate any possible malpractice, and to report promptly to the United States Bureau of Investigation cases which deserve investigative attention. Recommendations were also made at that time tending to eliminate certain inequities which had been found to exist, and at the same time to enable certain frauds to be punished which are not now classified under the law as crimes.

4. In addition to those frauds practiced in bankruptcy cases there are a large number of crimes which may be described in general as credit frauds. The United States Bureau of Investigation conducts many investigations of such crimes. To illustrate—one scheme by which property is sometimes obtained illegally consists of the taking by conspirators of the name of some legitimate concern with a high credit rating merely for the purpose of ordering goods by mail from wholesalers. As soon as these goods arrive at freight stations, they are secured and the conspirators disappear. This, of course, is a swindle, and usually in violation of the Interstate Commerce laws, which prohibit the use of false or fictitious bills of lading or misrepresentations in connection therewith. The largest group of credit frauds is those which are punished under the statute prohibiting the use of the mails to defraud, and in this class of crime complaints are usually first made to Post Office inspectors, who obtain evidence of the mailing of literature misrepresenting financial standing or facts upon which creditors rely in shipping merchandise, or upon which customers rely in investing money. Practically all cases of this kind of any importance are investigated by the representatives of the United States Bureau of Investigation, inasmuch as it possesses, as indicated in the foregoing, a force of special agents who are experts in accounting. The evidence obtained by accounting methods is, in the vast majority of cases, employed in these instances for the purpose of obtaining convictions. These cases include stock frauds, security swindles of all kinds, as well as the fraudulent management of large corporations or chains of corporations, which in the past few