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BUSINESS AND INVESTMENT FRAUDS PERPETRATED AGAINST THE ELDERLY: A GROWING SCANDAL

A REPORT

BY THE

CHAIRMAN

OF THE

SELECT COMMITTEE ON AGING

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PREFACE

The purpose of this report is to examine the panoply of business and investment frauds which are among the many schemes most frequently perpetrated against the elderly.

This subject is important because senior citizens are increasingly being victimized by con men who, under the guise of legitimate investment or business opportunities, offer only false promises of financial security. The elderly make up 11 percent of the population but almost 30 percent of the victims of crime in the United States. The area of economic crime is one of the fastest growing kinds of all crimes against the elderly, according to U.S. Police Chiefs responding to a recent Aging Committee questionnaire.

The frauds which are examined in this report are particularly vicious because they prey on the fears of retirees or those soon to be retired that they will not have enough income to support themselves.

This fear is real since 25 percent of the elderly have incomes placing them at or near the poverty line. In general, those in retirement can expect substantially less than half of the income they had while they were working. Recent publicity about possible cuts in Social Security has served to fuel the fears of the aged about their economic security.

As a result, it is not uncommon for seniors to pay $25 in answer to an ad which says they can make money stuffing envelopes or knitting baby booties at home. If they have a few more dollars, they might invest in a jewelry distributorship or a plant growing franchise. The problem is that many of these opportunities advertised in local newspapers are frauds.

Take the case of Nita Brumley of Lubbock, Texas, a nurse who retired from hospital work. She was looking for something she could do and scraped together some $3,475 for a jewelry distributorship. She was supposed to receive several display cases and the jewelry to fill them in order that she might make sales. The problem is, she received nothing at all for her money.

Mr. and Mrs. Barney Dial, who live outside of El Paso, Texas, took out a mortgage on their home to buy a plant-growing franchise. Their efforts to provide employment for Barney when he retired and to provide a means of support for their 42-year-old handicapped daughter went up in smoke. They paid $6,500 for a greenhouse, plants and supplies, and the promise of the firm that it would buy back the plants they grew. The greenhouse they received had defective insulation and the parent company went out of business without buying a single plant. Mr. and Mrs. Dial are still paying off the mortgage on the greenhouse at the rate of $153 a month.

Those seniors with a little more money might invest in vending machines. Arthur Shaffer of Columbia, a retired captain in the Army, who served in World War II, Korea, and Vietnam, had recently suffered a heart attack and was looking for some way to provide income to his family in the event of his death. He invested $9,000 in certain vending machines but received nothing for his money.

Some older Americans who are a little better off try investing in the commodities market. Mr. D. H. Brinson, age 73, of Reidsville, North Carolina, thought he was investing his money with a reputable dealer. He didn't see any way that things could go wrong since he was investing in silver. The problem was he was dealing with con men and he lost over $52,000.

The pages of this report contain hundreds of other examples from Committee files. These examples are illustrative, not exhaustive. They are typical of what we found in the course of our examination of the issue. The number of these cases, the size of the losses and the magnitude of the psychological damage to the victims of such schemes lead to only one conclusion: present efforts to deal with such problems have not been effective.

This report concludes that the U.S. Postal Service does an excellent job of curbing abuses, but that their authority and resources have been limited. It suggests the need for enactment of H.R. 3973/H.R. 7044, the legislation I have introduced along with the Honorable Matthew Rinaldo, the Ranking Republican Member of our Committee, and over 300 other Members of the House, to strengthen the authority of the U.S. Postal Service to crack down on such frauds. It is my hope that this legislation can be enacted immediately. With every day that we delay, more senior citizens will find themselves victimized with little or no recourse.

Finally, I would like to commend the individuals who assisted with this report. Our investigation of business and investment fraud was undertaken by then Senior Counsel Val J. Halamandaris with assistance from professional staff member Kathleen Gardner Cravedi and Federal Trade Commission attorney Dayle Berke, who has been detailed to our Committee.

CLAUDE PEPPER, *Chairman.*

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getting by on their social security and other meager earnings. The desire to be financially independent, to be secure and not dependent on relatives, particularly when a health crisis hits, all drive them to listen to the siren song of "get-rich-quick" promoters. Seniors may feel pressured by inflation and therefore react warmly to ads which suggest that they could do better than to leave their money sitting in a passbook account where it generates only 6 percent interest. With respect to some senior citizens, old age has brought with it a decreased mental ability and decreased capacity for the exercise of common sense and good judgment. Still others are lonely or bored, and the come-on of the con man sounds both exciting and potentially beneficial.

It is evident from our review of the files of the U.S. Postal Service, which has an aggressive program to identify and prosecute promoters of phony business opportunities and phony investment schemes, that senior citizens are disproportionately represented in the nets of get-rich-quick artists. It is no secret that the elderly, most of whom are on fixed incomes, are much harder hit by these kinds of promotional schemes than are younger members of society. There are numerous cases where unscrupulous con men have literally taken the entire pension, life savings or total net worth of senior citizens, leaving them with nothing.

The purpose of this paper is to explore these different kinds of fraud and the extent to which they are perpetrated against the elderly. In addition, to reviewing the files of the U.S. Postal Service, the Committee reviewed all the related cases reported by District Attorneys throughout the United States through the courtesy of the National District Attorneys Association, which allowed the staff the use of their Economic Crime Digest. The Committee staff also met with the Securities and Exchange Commission, the Federal Trade Commission and the Commodities Futures Trading Commission, all of whom cooperated and provided access to their files. In addition, questionnaires were sent to all State Attorneys General and State Departments of Consumer Affairs, as well as State Units on Aging, and all County and Municipal Departments of Consumer Affairs. In addition, various books and periodicals were researched, and contact was initiated with selective offices of the Better Business Bureau, and senior citizen organizations. Finally, hearings we conducted by the Committee on business frauds in September 1981.

What emerges after analysis of thousands of case histories, many of which are included in this paper, is a pervasive pattern of fraud which seems almost out of control. State and Federal regulators candidly testified or admitted in interviews that they are not making much of a dent in the problem. These same regulators blamed the lack of resources and the insensitivity of the criminal justice system which they charge is geared to deal with violent crime and not with white collar violations.

These facts and cases taken together demonstrate a clear need for immediate reform. Since the so-called "police powers" continue to reside with the States in matters of criminal law, the states shall continue to bear the greatest burden. The State of Georgia apparently has made some significant inroads through its business opportunity statute. Georgia may provide a model for other states. This report also

includes suggestions which the Congress may wish to consider. The suggestions primarily relate to ways to improve the effectiveness of the U.S. Postal Service whose Inspection Service is charged with fighting such frauds but apparently, the Service does not have the authority it needs to do the job effectively.

One thing is certain, the problem is serious and it is growing. The Congress and the States must act at once to deal with this mushrooming pattern of ripoffs perpetrated against the elderly and other vulnerable members of society.

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II. PERSPECTIVE

In May of 1982, the House Select Committee on Aging sent a questionnaire to the Police Chiefs of major U.S. cities as well as to each State Attorney General and Department of Consumer Affairs. It was no surprise to learn that business and investment frauds ranked high on the list of white collar crimes perpetrated against the American population. Similarly, it was no great surprise to learn that this is one of the significant frauds in which the elderly are involved.

The questionnaire indicated that the elderly are disproportionately victimized by criminals. Senior citizens make up 11 percent of the population but constitute about 30 percent of the victims of crime. Although violent crime is on the increase, a very sharp increase was reported in economic and non-violent crime—which is to say fraud.

What is fraud? Most people know it means being cheated or swindled. Lawyers talk in terms of depriving another of his or her personal property by trick, deceit, stealth or false representations with intent to keep the money or property obtained in this manner and to convert it to one's personal use.

Why is fraud on the increase? The police chiefs told the Committee that in times of economic turbulence, high inflation and high unemployment, the incidence of fraud tends to skyrocket. They said there will always be a hard core who think fraud is an easy way of making a living but in hard times, people who are otherwise honest sometimes resort to swindles, to support themselves and their families.

Why are the elderly so vulnerable to the con man? The answer seems to be that they are often afraid; that they are often more trusting and that many of them do not have much experience with investments. They also may have serious health problems which cost them a great deal of money. All of which serves to make magazine ads promising they can make money at home very attractive.

The fears seniors have about not having enough money are very real. About 25 percent of them have income which places them at or near the poverty line. In general, the elderly can expect in retirement to have only about 40 percent of the income they had when they were working. Many have only their social security to rely upon. Social security makes up the great majority of the income for about two thirds of the nation's elderly. The recent cutbacks in the social security program, although not as severe as originally recommended have contributed to the climate of fear. The elderly are being whipsawed by continued reports of the impending bankruptcy of social security and reports of new attempts to reduce benefits still further.

In an effort to answer all of the foregoing questions and to provide the Committee with a unique perspective, two former con men were brought from Federal penitentiaries to discuss these issues. The testimony of Hap Seiders is particularly insightful. He was convicted of fraud in the sale of counterfeit coins. He was making an estimated profit of about $1.5 million a year based on $3 million in sales. He testified as follows:

> I ran a scheme in which I would offer rare coins for auction by mail. This is an example. This is a silver dollar which has been altered with an engraver's tool and a magnifying glass. I had experts who could make a coin look any way that I wanted them to look. I bought this coin for $100. As you can see, it looks like a 1799 silver dollar. If it were genuine, it would be worth about $5,000. In my ad, I would say the highest bidder would get the coin. I played on people's greed really.
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> There were any number of people who thought they would send in a low bid "just in case" to see if they might get a windfall. In the case of this coin, I would get several offers for say $3,500 to $4,100. I would accept the $4,100 offer and send an invoice. Those who received my invoices could not send me their money fast enough. They thought they were getting a real bargain and they wanted to push through their end of the deal before I changed my mind or something. When I received the cashier's check for $4,100 I sent the coin. The coin looks authentic to all but the most discerning and I had made myself a quick $4,000.
>
> Mr. Chairman, I am not proud of what I did. I am very sorry. I felt some guilt at first but then I began to rationalize that I was not hurting anyone. I fooled myself into thinking that what I was doing was not a crime. We all get swindled one way or another. For example, the minute you drive a new car off the lot it is worth half of what you paid for it. I justified it to myself because so many of my competitors in the field were doing it and none of them had been caught even though they boasted of schemes going back many years.

On the question of the vulnerability of the elderly, he said:

> I particularly regret the times that I and my sales team defrauded the elderly. With the rate of inflation being what it is and human nature being the way it is many people, particular the elderly were lured into making questionable investments. The elderly are vulnerable, they make easy marks for the con man. There are many reasons for this.
>
> For one thing, they grew up in a different, more trusting, less cynical era. For another thing, the elderly usually have some money somewhere, either they bought a house 30 years ago and it has appreciated tremendously or a spouse has passed away leaving the proceeds from a life insurance policy. The third thing is that they are not accustomed to spending a lot of money or investing throughout their lifetimes and they make easy marks for fast talking salesmen because of their limited business experience. The final factor is what I call a desire for immortality, they are often consumed with the desire to do something or leave a little something for their children or grandchildren. All these factors together with the notion of continuing to provide for themselves in independence throughout their later lives combines to make them easy targets, and deserving of special protections.

Mr. Seiders said that frauds against the elderly was big business. The work is easy, extremely lucrative and the chances of being caught and punished are slim:

> The one thing that I have learned by being in prison is there are a million schemes from phony stocks and commodities to land deals which can be targeted against the elderly and there are thousands of con men in prisons who are being reeducated who can hardly wait to get out to try some of the new schemes that they have learned in prison. There is so much money involved and the chances of getting caught, prosecuted and sentenced to jail are so slim that many con men look at jail time as an acceptable professional risk.

Mr. Seiders was asked which of the State or Federal agencies are feared by con men. He responded that state agencies, with some few exceptions, do not cause con men to lose much sleep. He said the FBI could do so but con men know the FBI is stretched thin and that white collar crime enjoys low priority. He contended, as did Earl Wilt, who was convicted of running a massive commodities fraud based in three states, that U.S. Postal Service inspectors cause them the most problem. Both Seiders and Wilt characterized the Postal Service inspectors as highly trained and proficient. Both Seiders and Wilt were caught and brought to justice by the Postal Service.

Seiders offered this suggestion:

I would urge you to strengthen the hand of the Postal Service whose investigators are effective but who are hamstrung by the lack of authority which prevents them from moving until there is evidence that a significant number of people have been injured. By then it is too late. The money is gone. I think the Internal Revenue Service should play a greater role investigating such frauds because tax fraud goes hand in hand with any other kind of business or investment fraud.

At the Committee's September 11, 1981 hearing, a law enforcement perspective was provided by Sandra Bourbon, who is charged with enforcing Georgia's Business Opportunity Fraud law. Ms. Bourbon has qualified as an expert on this subject in both Federal and State Court and her work has also been recognized in law enforcement circles. She told the Committee that 30 percent of the business opportunity fraud discovered in Georgia during 1981 was directed at the elderly. She said the problem was massive and that her office handled $15 million in complaints in that year alone. Her testimony reads as follows:

There are many problems associated with stemming business opportunity fraud. We regulatory as well as law enforcement agencies are seriously outnumbered. This hampers educational programs as well as enforcement of the law.

Certain agencies are restricted in sharing information: State agencies such as Pennsylvania, Illinois, Washington, Oregon. Federal agencies, such as IRS and, until recently, FTC have not been cooperative in sharing information with other agencies. Newspapers have not cooperated in screening business opportunity advertisements.

There is a lack of competent, well-trained local prosecutors. The U.S. Attorney's Office in the Northern District of Georgia selected an attorney over a year ago who was to train local prosecutors. The program was apparently never implemented.

In Georgia, our two or three District Attorney Generals who understand white-collar crime cases are as overloaded as our Attorney General's Office, which is not as familiar with the prosecution of criminal cases. In court, many cases are lost because the juries fail to understand sophisticated fraud.

She continued:

The length of time required to investigate and prosecute business opportunity fraud oftentimes strains a limited staff. There seems to be an emphasis on prosecuting crimes of violence, not white collar crime, which was reenforced by a statement made recently by our newly appointed U.S. Attorney.

Prosecutors generally never seek restitution. If IRS in its investigation and prosecution of a crook discovers assets, it is forbidden from sharing this information with other agencies or, heaven forbid, the victims. The end result of these deficiencies is that the crook is never convicted.

Whoever said, "Crime doesn't pay?" The odds are great that the con artist will get away with his shabby scheme. Respect for the law can only be achieved by enforcement of the law.

Ms. Bourbon talked briefly about Georgia's Business Opportunity statute which she said requires registration as well as disclosure:

I should add this disclosure is information that is provided to the potential investigator two days before he makes a decision as to whether to buy a vending machine distributorship or something of that nature.

If the company offers the potential investigator any kind of investment guarantee or refund or repurchase agreement, which is usually something phony, the company has to post a $75,000 bond. This means that if the consumer is defrauded that he would have perhaps access to some restitution.

We also have the legal jurisdiction to question fraudulent advertisements or sales representations. In other words, if we see a phony looking ad in our local paper we have the jurisdiction to obtain the information from the company to substantiate the types of claims that are made in the ads.

She added that the Georgia Business Opportunity law requires business to furnish to the media an advertising identification number, which is issued when the company has registered with the Office of Consumer Affairs. She continued:

We are asking the newspapers to place a statement in the business opportunity advertisement section that would advertise potential investigators to call our office, the Office of Consumer Affairs, to check out the company before investing.

She concluded calling for tougher prosecution and for increased cooperation among Federal and state agencies, noting that the Federal Trade Commission had only recently begun to share information and that many states such as Pennsylvania have yet to do so. She did note that the State of Iowa is publishing a newsletter as a means to facilitate the exchange of information. She called it "an early warning system" the purpose of which she described as "to advise us on 'who is doing what to whom.' " She said:

The only way we will ever stem business opportunity fraud is through the combined efforts of educating potential investors, "cleaning up" the advertisements in newspapers and magazines, obtaining information through a network of agencies using our combined techniques, and more effective prosecution with adequate sentencing and restitution.

Ms. Bourbon was also called to testify before the House Post Office Committee in its May 20, 1982 hearings. She said at that time:

We in Georgia support efforts to strengthen the authority of the U.S. Postal Service (by giving them) subpoena power and authority to issue cease and desist orders.

III. A KALEIDOSCOPE OF BUSINESS FRAUDS

The purpose of this section of this report is to acquaint the reader with the vast variety of business and investment schemes which are perpetrated. The examples are only illustrative. There are thousands of similar cases in the files of the House Select Committee on Aging and other thousands of cases retained by Federal agencies such as the Federal Trade Commission and by each of the State Consumer Affairs Departments. These cases fall into about five main areas: (1) work-at-home schemes; (2) securities frauds; (3) phony franchises; (4) distributorship frauds, and (5) commodities frauds. It was clear to the Committee staff after even a cursory review that these examples are more epidemic than episodic.

A. Work-at-Home Schemes

Work-at-home schemes are almost exclusively targeted against the elderly. Senior citizens are enticed by advertisements in newspapers and magazines which tell them that they can earn several hundred dollars a month by stuffing or addressing envelopes, making wreaths or plaques, knitting baby booties, growing earthworms, watching television or raising chinchillas home. Officials from the U.S. Postal Service, which has been investigating these schemes for years, have stated that they have yet to encounter one legitimate work-at-home offer.

In work-at-home schemes, the come-on is the promise of a good income which can be earned at home. Usually, a fee is required in order for the person to get in on the opportunity. The promoter of the scheme claims that the money is for a start-up kit or for other expenses. The promise is that the promoter himself will buy back the finished product or that he will arrange for it to be purchased by others in the marketplace. Unfortunately, the promoter seldom if ever buys back the products, and the consumer is not only robbed of his initial cash outlay but is also stuck with a large quantity of products for which there is no market.

The following case histories illustrate the types of work-at-home schemes which are commonly promoted in today's marketplace.

1. ENVELOPE STUFFING AND ADDRESSING

According to the U.S. Postal Service, the most common offering in work-at-home schemes is for envelope stuffing. Senior citizens respond to advertisements that represent that they can earn hundreds of dollars a month stuffing or addressing envelopes. They are told that they must pay a fee of $15 to $100 to receive envelopes and instructions and that the company will buy back the stuffed envelopes. In most cases, persons that do send in the money never hear from the company again. Examples follow:

—Chief Postal Inspector Kenneth Fletcher, testifying before the Aging Committee on September 11, 1981, told of a recent work-at-home scheme involving a promoter who enticed over 25,000 persons across the country to invest $12 each with promises of income ranging from $180 to $500 per week. Operating through 15 different company names and addresses in California, Lawrence Phillips placed classified advertisements in daily and weekly newspapers from the west coast to the east coast and mailed promotional material throughout the country soliciting homeworkers to join his program in which they would earn a weekly salary by just stuffing envelopes. For a $12 application fee, investors received a booklet which explained how to "Make Money in Mail Order" by being a distributor for the Phillips Envelope Company. This required the placing of classified advertisements similar to the ones which enticed them to invest in publications and mailing circulars soliciting additional people to join in the pyramiding fraud scheme.

False representation orders were issued on February 27, 1981, and July 15, 1981, to encompass all 15 promotions operated by Phillips.

—A Nashville, Tennessee, company sent a letter to approximately 23,000 people throughout the country stating that the firm needed individuals to work in their own homes stuffing envelopes. Individuals were promised they could earn $750 per 1,000 envelopes stuffed. A $15 "registration" fee was required to participate. Those who sent in their money never heard from the company again. Two of the three operators were sentenced while the third remains a fugitive.

—A New York association guaranteed persons the opportunity to earn sizable incomes by stuffing envelopes in their homes. The opportunity was particularly attractive since the association falsely represented that it had been approved by President Carter and sponsored by 1,000 large American corporations. To gain a lifetime membership, an applicant was required to remit a fee which was initially set at $55 and gradually increased to $375. Once in receipt of the fees, the association failed to furnish any materials. The scheme victimized 79 persons, bringing in over $15,000. The operator was placed on parole and fined $4,500.

—In Lufkin, Texas, individuals were induced to join an organization on the promise that members would be paid $60 for every 100 envelopes which they addressed and stuffed with an insert. Rather than receiving the raw materials for stuffing and addressing, those who sent in the $12 membership fee were advised to earn money in the same fashion employed by the organization. During the six-month period this scheme was in operation, victims sent in funds totalling in excess of $87,000.

—A company promised weekly earnings of $400 to $700 for stuffing envelopes at home. The company's advertisements used 25 different company names and nine different post office boxes. Respondents to the advertisements received no reply from the company listed in the ad; instead, they were contacted by a publishing firm which offered earnings of $600 weekly for selling a book. Respondents were required to pay a $20 membership fee before they were eligible to become "commissioned mailers." In return for submitting the membership fee, applicants received 20 circulars advertising the book, 20 postage stamps and 20 names and addresses. Two of the addresses were controlled by the company officer and the remaining 18 were duplicated as many as 50 times each. The victims could not sell any of the books because of the duplication of the names and addresses. The company officer was sentenced to prison.

2. TELEPHONE SOLICITATIONS

"*EARN $200 weekly, part-time taking short phone messages at home. Call 1-615-779-3235 ext. 267.*"

Senior citizens are often attracted to advertisements such as above which promise that they can make money by taking "short messages" on their home telephones. With expectations of setting up answering services in their homes, they send in application fees, only to receive pamphlets on how to answer telephones or information on how to make money by placing advertisements like those to which they originally responded. For example:

—Chief Postal Inspector Kenneth Fletcher, in his September 11, 1981, testimony before the Aging Committee, gave the example of a promoter operating in Palmer, Tennessee. Advertisements were placed in publications announcing that over $200 a week could be earned, part-time, by taking short telephone messages at home. Investors were told that all they had to do was simply take names and addresses for the American Switchboard Association. For a $20 application fee, they received a kit containing four booklets describing procedures for setting up their own telephone answering service. Essentially, this was to place advertisements similar to those placed by American Switchboard Association, with a telephone number, and have people call them for orders. No salary was paid—the only income generated was money taken from additional victims. Approximately 3,500 individuals, many of whom were elderly or disabled and looking for part-time employment, invested more than $72,000 in this fraud before it was put out of business.

3. INVENTOR SCHEMES

Ads such as the following have a great appeal. Unfortunately, they are sometimes placed by con men intent on separating would be investors from their money or invention or both.

IDEAS, INVENTIONS, new products needed by innovative manufacturers. Marketing assistance available to individuals, tinkerers, universities, companies. Call free: 1-800-528-6050. Arizona residents: 1-800-352-0458, extension 831.

Inventor schemes prey on those who are eager to have a product patented or accepted by the public. Fictitious companies offer to market and patent inventions or other personally produced items. The costs to the investor in these schemes are generally higher than most work-at-home schemes, often running as high as $1,000. Few of the promises to investors are ever carried out, and once the lump sum is paid, the company or promoter is never heard from again. Examples follow:

—Two operators in Dallas, Texas, induced 235 persons to pay them $233,000 for promised assistance in promoting and marketing ideas and inventions. The operators solicited clients who had ideas or inventions they were hopeful of marketing. For a fee of $950, the company agreed to conduct a patent search at the U.S. Patent Office, make an evaluation of the invention, file a disclosure document with the Patent Office, determine the feasibility of marketing the invention to qualified manufacturers, and serve as the inventor's agent in negotiation with any potential manufacturers. Few, if any, of the promises were actually carried out.

—Mr. L, an inventor from Maryland, responded to an ad in the paper for a company claiming to market inventions. The company failed to disclose the cost of its services until he had spent $350 for an evaluation report. Whereas Mr. L was led to believe that the most he would have to spend was a total of $350, the company wanted an additional $1,695 to market the idea.

—A San Diego marketing firm falsely promised to develop and market inventions for a fee. Approximately 2,000 fledgling inventors paid fees that averaged $1,500 to $1,800 to the firm. Victims' losses totalled approximately $2.75 million. Five persons were convicted of conspiracy and mail fraud charges.

4. EMPLOYMENT OPPORTUNITY FRAUDS

This is a typical come-on for work-at-home employment opportunity:

Assemble electronic devices in your home spare time. $300.00–$600.00/week possible. Experience, knowledge, not necessary. No investment. Write for free information. Electronic Development Lab, Drawer 1560-L, Pinellas Park, FL 33565.

Thousands of senior citizens respond to such ads annually in their effort to supplement their retirement incomes. Unfortunately, many find their already dwindling resources further depleted.

Employment opportunity schemes involve assembling kits or parts bought from a company based upon a promise that the company will buy back the assembled product. Projects range from growing house plants to assembling wall plaques. All of these employment offers require an initial investment ranging from a few dollars to several thousand. After the project is completed, the company typically refuses to buy back the product either because it does not meet "company standards" or because it is made of faulty materials. Often, a company will close up shop after collecting the investor's initial deposit. For example:

—A Nevada company sold molds and materials for making fiberglass van shields and other plastic automobile accessories, guaranteeing that they would buy back all parts made by investors. A $7,850 fee was required for the materials and molds. Investors often received faulty molds and were not able to make parts which met the "quality control standards" required by the company before they would back the completed products.

—Mr. S of New Haven, Missouri, responded to an ad in his local paper soliciting persons to make products in their homes for the

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benefit of a California-based company. The scheme involved making wall plaques and picture frames out of polyurethane foam. Mr. S invested $7,900, which necessitated his having to take out a second mortgage on his home, based on promises that the company would buy back the completed products. The company did not buy the products, and Mr. S had to sell his home to pay off the second mortgage. Some 700 other people across the country put up and lost $7,900 in this scheme. Although a conviction was obtained against the company, there were no remaining assets which could be returned to the victims.

Mr. and Mrs. Barney Dial gave the Committee an affidavit which was entered in the record of the September 1981 hearings. Excerpts are carried here because it describes this unhappy experience with great detail and force which it is hoped will serve to educate the public.

Mrs. Dial told the Committee that she and her 42-year-old daughter, Connie live near El Paso, Texas and that they answered an ad in the local newspaper in April 1978. The ad was in the business opportunity section and said that thousands of dollars could be made each year by growing plants "in your backyard." Mrs. Dial said:

> Since Barney was about to retire and suffers from emphysema, we were looking for something that he could do that would not be too taxing as a way of supplementing his social security retirement income. Since my daughter had polio as a child and has been confined to a wheelchair ever since, we were also looking for a business in which she could contribute and Tom Thumb Plant Centers looked ideal.
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> We called the number on the ad and made an appointment with Mr. Conte who arrived at our home armed with pictures of greenhouses and papers showing projected profits. The ad had suggested we could make $13 to $14,000 a year. He told us that he would guarantee that we could make at least $9,500 a year for our initial investment of $6,500. He said that for that amount of money he would provide: (a) a fully functional greenhouse 14′ x 27′ in our back yard, (b) some 4,000 healthy starter plants, (c) the soil for the first planting, (d) all the pots we needed, (e) perlites, (f) fertilizer and, (g) insecticides. He described our investment as a turnkey operation meaning that in exchange for our $6,500 he would provide us with everything that we needed to produce healthy plants. He said that if we raised plants of good commercial quality he would buy them back from us after eight weeks paying us a minimum of 80 cents a plant. He said: "I don't see any way where you can get hurt because you pay off relatively fast. In other words, each time you get paid that's that much less you have in your investment."

The Dials took out a $6,500 mortgage on their home and made the first payment of $3,000 on April 6. The greenhouse was supposed to be ready on May 3. Mrs. Dial said from the very beginning the greenhouse was a disappointment:

> The men constructing the greenhouse came from Tucson. They were in such a hurry to get home that they took all manner of shortcuts. The reef was supposed to be of frosted fiberglass to reduce the effect of the desert sun. We were told they quite making the frosted and ordered the fiberglass. The fiberglass was mounted crooked on the roof so that the panels did not match properly. The greenhouse leaked like a sieve. We complained and the company sent back its workmen who merely squirted sealing compound in a few places and left again. We called again to complain. No response. We had been promised that the clear fiberglass would be painted or that the company would install a shade cloth over it. Nothing happened. The temperature inside the greenhouse hit 120 degrees. Finally, after more calls the company sent back the workmen who threw parachutes over the roof and haphazardly nailed through the fiberglass, often missing the wood beams and thereby causing more leaks. After a number of calls we came to the conclusion that more pleas would be useless and my husband had to climb up on the roof himself. He used more than a dozen tubes of caulking compound before the roof was reasonably waterproof.

She told the committee that even though the contract did not call for the payment of the remaining $3,500 until after the greenhouse was complete, the salesman came by and said he needed the money and if they would pay the remainder in advance, he would discount the contract $500. The Dials paid the remaining $3,000. Mrs. Dial continued her story:

> But the battle continued. The more work the men did, the more they left undone. We had to call the plumber and the electrician. The heater they installed in the greenhouse was not connected. The thermostat was not operational. The vent pipes were not wrapped in asbestos. The air conditioning did not work effectively. We were promised six grow lights but got only two and even then they were not connected. They promised to move gas and water lines that ran under the greenhouse but did not do so. We called and called but nothing happened so my husband wound up making the repairs or we paid to have them done. The company told us to save our receipts. They said they recognized this was their responsibility and that they would pay us back.
>
> Later, we discovered that they had failed to construct two tiered benches to accommodate the plants as called for under the contract. We needed as much room as possible to store the plants. When we called they said not to worry because the oversight was purposeful. They said they were planning to put a sprinkling system in for us. Soon, they told us the bad news that the sprinkling system would not work in our greenhouse because of some flimsy excuse.
>
> The company had promised to build cement walk ways in the greenhouse so that my daughter could navigate her wheelchair through it to tend the plants. The men even measured her wheelchair. The company on its own decided the walkways would be of wood and not cement. It would not have done any good to protest. The men threw down large pieces of plywood, put wooden blocks under the corners and nailed not into any foundation, but into the sand. Needless to say the plywood pulled up easily and the platforms were anything but safe and secure. Once again my husband was left to try to make something out of the mess they left. "Save your receipts, they told us."
>
> The 4,000 plants we were supposed to receive to start our business were never delivered. We received about 500 plants altogether and they were badly infested with tomato worms and leaf rollers. We protested and asked for insecticides. Nothing. We had to buy some insecticide from a local nursery. We asked for more of our promised plants and were given excuses about the shipper having problems and a blight in California had destroyed their expected supply. We found out later the plants we had received initially came from 15 miles from our home.

She concluded:

> We finally completed the greenhouse ourselves. We bought plants and tried to sell them with little success. There were recurrent rumors that the company was going bankrupt. We asked about our money, they said to be patient. We raised numerous plants of good quality but they did not buy back a single one from us. The only money we received was a $162.00 check in repayment for shipping expenses we had paid in June. By January 1979 the company severed their relationship with us and went bankrupt. We were left with a $6,500 mortgage which we are still paying off at the rate of $153.00 a month. We learned that they swindled over 30 people, most of them elderly, for a total in excess of $150,000.
>
> We hope this Committee can do something to protect other older Americans from those who would steal their hard earned dollars through fraud and deceit at the very time in their lives when they need income the most.

5. CHINCHILLA RAISING

Promoters of chinchilla ranches promise that individuals can earn thousands of dollars a year in their spare time by raising chinchillas. Promoters claim that for an initial investment of several hundred dollars, one can be assured of a lifetime income. Typically, the chinchillas are sold for about $300 each. Promoters falsely represent that in less than a year the chinchillas will more than pay for themselves, since a chinchilla pelt can bring $100–$300 and since each pair of chinchillas will produce from 6–8 offspring a year. In fact, chinchillas do not average 6–8 offspring a year, and infant mortality can be as high as 20%. Furthermore, the average price received for chinchilla pelts in the U.S. is approximately $14, and good chinchillas can be purchased from professional breeders for $25 to $50 each.

As an illustration of the problem:

—Mr. and Mrs. H of Ball, Louisiana, invested over $4,000, on the promise that they could receive huge profits from producing and raising chinchillas. The company from whom they had purchased the chinchillas promised to buy them back. Once having invested their money, Mr. and Mrs. H never heard from the company again. They ended up giving the chinchillas away.

6. BABY BOOTIES AND CHRISTMAS WREATHS

Many senior citizens respond to ads which tell them they can earn money knitting baby booties or making Christmas wreaths at home. The promoters again promise to buy back the finished products. As always, there is an obligatory fee for participation, but the company seldom if ever buys back the products.

—Mrs. C. A. of Hartford, Connecticut, age 75, sent in her money to a firm that said they would pay her to knit baby booties. The money was said to purchase starter kits which gave an indication of the specifications and quality which were expected. The representation was that there was a ready market for such items which the firm could not keep in stock. The firm promised to buy all she could produce. After spending hundreds of hours producing hundreds of such items, Mr. C. A. was told that she would have to find her own clients.

—Fletcher F. Acord, Assistant Chief Postal Inspector, in an October 1, 1980 hearing before the Aging Committee, told of a promoter who offered work-at-home employment making foundations for Christmas and funeral wreaths. The operator, Harry Morrison, formed a company called W. C. Wreath Co., and guaranteed to purchase these foundations for $1.50 each. Morrison also guaranteed the investors they would be earning more than $1,200 per month. No wreaths were ever purchased by Morrison. 300 senior citizens from Florida invested $47,000 in this promotion. Mr. Frank J. Gruber of Titusville, Florida, a 68-year-old retired machine designer, made 500 wreath foundations and personally took them to Morrison. Although Morrison assured him they met quality standards and that W. C. Wreath Co. would buy them, none of the wreath foundations were ever purchased. Morrison was later arrested and convicted of fraud.

7. WATCHING TELEVISION FOR FUN AND PROFIT

Advertisements soliciting people to make money watching television are particularly appealing to the elderly. Individuals are told they will be paid for giving their reactions to programming or commercials. Typically, once they send in their fees for participation, they never

hear from the company again. As an example, Mrs. B. S. of Los Angeles, California was informed that if she paid a "registration fee" she would be among those selected to watch various T.V. game shows for purposes of evaluating the hosts and the program in general. Those making the offer said they were representing a major corporation which was trying to decide where to spend their advertising dollar. Mrs. S paid her money, watched for several weeks, sent in her reports but was not paid the $10 an hour she was promised.

8. WORM FARMS

Promoters of worm farms promise potential investors that there is a large market for commercial worms and that huge profits can be made from growing them. Investors pay thousands of dollars to invest in worm growing packages, only to find that there is no market for their worms. Examples follow:

—Mr. S. H. of El Cajon, California, was one of several people defrauded by a Texas firm which encouraged investors to grow earthworms. The company ssaid that it would buy back the adult worms at $44 a pound and falsely asserted that large profits would be possible because it had developed a special large worm which ran 350 to the pound. Mr. H. invested $11,130 because of the representations made to him. In fact, it took 1,000 worms to make a pound, the company paid at a much lower rate, and there was no market for the worms. All Mr. H. ever received was $237.57, which the company paid him for one shipment before it went out of business.

Chief Postal Inspector Kenneth Fletcher told the Committee about another similar case:

—National Worm Growers Exchange, Smyrna, Tennessee, placed ads in numerous newspapers throughout the United States and Canada soliciting individuals on retirement or fixed income to raise earthworms in their backyards. Interested customers were told by National Worm Growers Exchange's sales representatives that because of an earthworm's many uses, worms were in huge demand and that National Worm Growers Exchange desperately needed growers to help satisfy the overwhelming market. Victims were promised that very little work was required—that earthworms multiplied so rapidly, they practically grew themselves—and that National Worm Growers Exchange was ready to buy back all worms at a large profit to the growers.

For an initial investment of $2,000, victims received 30 pounds of worms, some newsletters acclaiming the many successes of worm farms, and an earthworm cake recipe—and that is all they received. Over 2,000 victims lost $3.5 million to this fraud. The five individuals responsible for this scheme were sentenced last year to 3 years in prison with probation ranging from 3 to 5 years.

Mr. Edward Steinleitner testified before the Aging Committee on September 11, 1981, and told how he and his wife had lost some $30,000 plus interest.

> My wife and I answered an ad in our local paper and soon thereafter went to one of several seminars given in our town by two people who alleged to be owners of an earthworm distributing company. We were told that earthworms

were a lucrative business and that the firm could not keep up with the demand. The firm said that it wanted to employ people like us to grow earthworms which they would buy back from us.

We were told that our business would: (a) be inexpensive to run; (b) did not require much capital to begin with; and (c) could easily be operated in our backyard. I have strong feelings about improving the environment and leaving the generations who come after us with as much of the natural beauty of this country as we can. I felt that in my own small way in this business I would be generating good topsoil and turning a nice profit on the side.

He continued:

We paid the firm $12,000. For this money we purchased not only the earthworms and supplies needed to get started but we bought exclusive rights to sell earthworms to the company from the five counties in Pennsylvania nearest our home; we bought the territory. We also purchased the right to sell other people on getting into the business. Supposedly, we were to get 2 percent of the company's profits from the sales of each of the franchises we placed. We were to give the company's guarantee of success and the guarantee that they would repurchase the grown earthworms from those who bought into the company through us.

We received our starter kit and began to grow earthworms as instructed. The company said they would buy them back from us at whatever they said was the going rate. My husband made two sales persuading two more people to grow worms for the firm. Unfortunately, the principals in the company skipped town and cannot be located to this very day.

He went on:

The company did not honor any of their promises to us. They did not buy back any earthworms. Not only that, we were left in a very bad situation. Since the principals could not be located, one of those who we had sold on the company brought suit against us for $127,000. Needless to say we were heartsick. We were morally injured by the experienced. We were emotionally distraught. Our health suffered from the anxiety and the sleepless nights. Our names made the front page of the newspaper under large headlines which proclaimed "Earthworm Fraud," and the natural conclusion was that we were among the conspirators, which is 180 degrees from the truth. We just settled the suit against us this past March for $10,000. In the meantime, we had to pay legal fees and carry the burden of this tragedy with us for more than 2 years.

B. Securities Frauds

Under the Securities Act of 1933, a "security" is an investment in a common enterprise in which investors are purchasing interest and where growth of that investment is to result from the efforts of the promoter. Types of securities include notes, stocks, treasury stocks, bands, certificates of interest or participation in any profit-sharing agreement, and certificates of deposit.

It comes as no surprise that fraud and abuse in the sale of securities has been rampant. Many senior citizens have invested in securities, thinking they have made sound investments, only to find the securities worthless and the possibilities of a refund nonexistent. The SEC had tried to make an effort to stop the fraudulent sale of securities. The U.S. Postal Service has also tried to stem the tide. However, there are many violations and because these cases tend to be so complicated, they require incredible amounts of time to litigate.

A classic example of a phony securities scheme follows below. The case involved Progressive Farmers Association (PFA). PFA was touted as a farmer's cooperative whose purpose was to build a chain of retail stores where farmers could sell directly to consumers. The

company sold notes, bonds and stocks over a five-year period, all of which were worthless because the company officers were converting the proceeds to their own use after paying salesmen their commission. According to Cynthia Clark Campbell, Assistant U.S. Attorney of the U.S. Attorney's Office in Kansas City, Missouri, which litigated the PFA case, some 6,000 people were taken for approximately $13 million in a scheme which operated in Missouri and Oklahoma. The trial lasted 11 months, one of the longest criminal trials in history. Ms. Campbell told the Committee that this massive fraud was perpetrated against mostly elderly victims, many of whom had invested their life savings in this scheme.

The case is described in the statement of Mrs. Mabel Nord before the Aging Committee in a September 11, 1981 hearing, which is included here in detail as the best way to acquaint readers with this problem.

My name is Mabel Nord and I live in Licking, Missouri. Before his death a few months ago at age 70, my husband Albert was a farmer. He worked hard all of his life. I am here this morning to tell you what happened to us with the hope that you will take action to prevent other senior citizens from being defrauded.

In November 1973, a salesman from a corporation called Progressive Farmers Association (PFA) came to our house and encouraged us to invest. He was selling what he called estate builders in order to finance the construction and operation of farmers' co-op grocery stores. The idea was to cut out the middlemen. He said we would be able to raise crop and livestock prices while cutting food prices. He said that as members, we would be able to get a discount on the food that we purchased.

The salesman showed us blueprints and drawings of the proposed buildings. He stressed that we would become one of the first 1,000 charter members which would bestow certain additional benefits. He told us that we would get one-thousandth of one percent of the gross sales after the first $100,000 had been deducted and that there would be great tax benefits to us because of our age.

We found out later that the estate builder they were selling was nothing more than an unsecured promissory note which was evidence of their debt to us. The way it worked, we had our choice of paying $360 a year for 12 years or three installments of $1,440 or one installment of $4,000. In addition to all the benefits described we were promised an excellent return on our money. At the end of the 20 years the company promised to pay us $15,791 for each estate builder that we purchased.

She continued:

We bought three estate builders and gave our chegk for $1,080 to the salesman for the first year's premium on them.

A year later another salesman from PFA came by our house and used an elaborate sales manual to influence us into buying bonds being offered by them. They told us the bonds were different than the estate builders and were protected just like those of banks. They also told us that the rate of interest was much higher than banks and that we could withdraw our money from the bonds at any time that we wanted. We bought three bonds with a face value of $4,000 each, making the total amount $12,000 for the three bonds. In April of 1975, almost a year later, yet another salesman arrived at our house who told us the company was trying to sell 152 shares of stock in the organization to each estate-builder holder. The salesman told us how well the company was doing and how fast they were growing. He told us that if we took out ten more estate builders at $360 each and kept them for just a year, we could keep the 152 shares of stock as a bonus. We paid them $3,600 for the 10 additional estate builders.

In 1976, we received notice that we had been credited with $1,077.18 in interest on the three bonds that we had bought, but at no time did we receive this money or any return on our investment. Finally, after several calls, they told us the interest on the bonds had been applied toward the second-year payments on the estate builders we purchased initially. This was contrary to our wishes and the company knew it.

In July of 1976, we went to the company's office in Springfield and told them we wanted to cash in the ten estate builders we bought a year ago. We also told them we were planning on keeping the 152 shares of stock they had promised to give us for taking them out. The company's president told us we could not cash in these notes because we had only paid one year's premiums. He told us that if we paid the second year's premiums we could borrow against the certificates as stated in the agreements. This did not seem right but we paid $3,600 rather than lose our investment.

In May of 1977, we heard that the company had gone bankrupt.

At the trial that took place last year, we learned that over 6,000 people had been taken in this elaborate scheme for a total of $12 million. As for the proposed markets promised, a few scattered here and there did open, enough to keep people thinking that the entire plan would materialize. We learned that the money we paid went to pay commissions for the salesmen who visited us, and the remainder was divided up by the four principals who thought up this scheme. The Justice Department documented that the four principals converted about $2.5 million to their own use.

She concluded:

We learned that 60 percent of the victims were senior citizens who like us had worked hard all of their lives to make this country great. We lost $21,360 at a time in our lives when we can afford it the least. Other people lost more. A 75-year-old man from Greenfield, Missouri, lost $84,000. Another senior citizen who had lost about $50,000 in this phony securities racket committed suicide as a result of the loss.

I understand that the principals who perpetrated this securities fraud were convicted of racketeering, obtaining money by false representations, and fraud and securities fraud. This is fine, but we have not been able to recover one dime of our investment. When it declared bankruptcy, the company had only $191,000 which could be realized when all their assets were sold to satisfy creditors.

Mr. Chairman and members of the Committee, you cannot imagine what a nightmare this was for all the members of our family. There were more sleepless nights than I care to tell you about. The effect was very devastating, and I feel this experience was a contributing factor in my husband's having a stroke in 1976, the complications of which resulted in his death this past July. I am sad that these kinds of frauds can take place on such a large scale and that so many older Americans can so easily be victimized. I would be grateful for anything you could do to make such frauds impossible in the future.

Another person who lost money in this scheme was Homer Branstetter, a 69-year-old farmer from Hartsville, Missouri. He submitted the following statement to the Committee:

Sometime in late 1973 a salesman for the Progressive Farmers Association (PFA) arrived at my home and told me that PFA was a newly formed company operating as a farmers co-op in the state of Missouri and that investing in PFA was much safer than putting money in the bank.

The salesman told me that if I were to invest $350 a year for 12 years that I would receive a certificate called an "estate builder" which would be worth $15,791.50 at maturity. He promised me a great deal more buying and selling power if I belonged to PFA. He told me that they were going to build a store in Springfield, Missouri at which members could buy cars, tractors, trucks and many other items at ten percent above cost, thereby cutting out the middleman. He told me that this store would be a market place for farmers to bring their product and sell it to the public.

He told us PFA would bring farmers closer to the consumer. He told us that we had better move fast if we were going to get in on the charter membership of the first 1,000 investors who were supposed to get a much higher dividend than the next 5,000 investors. I gave my check for $360 to the salesman to purchase one of the estate builders. A few weeks later, a second salesman from PFA dropped by and told me that time was running out for the first 1,000 investors and suggested that I buy another certificate. It was a high pressure sales pitch. He said the funds were needed to build a slaughterhouse and large retail outlet stores in the Springfield area. He stated that these stores would be established in such a way that farmers could lease a retail stall and sell produce

and meats directly to consumers. The salesman provided pictures of the proposed buildings and blueprints to be erected. He made it all sound good so I invested another $360 for a second estate builders.

A year later a third PFA salesman arrived with more tales about the growth of PFA and encouraged me to buy PFA bonds which he said paid nine percent interest, which was much higher than we could get anyplace else. He also said we could withdraw our money anytime we wanted from the bonds. We relied heavily on this promise before withdrawing $30,000 from our savings account for one bond with a face value of $30,000.

We heard that PFA salesmen were selling mortgages which were estate builders secured by property of some kind supposedly in the same amount as principal on the promissory note. We found out later that the property which they had purchased for $100,000 had been valued at $4 million by means of a fraudulent appraisal.

A few weeks before PFA went bankrupt another salesman appeared at our house and offered to sell us stock in the company. We declined the offer.

At the trial or from Postal Service investigators, we learned that about 100 percent of the money that we paid in went to commissions split among the salesmen and PFA officers. Obviously, we would not have invested had we known this point. Needless to say, none of the stores ever opened. The slaughterhouse was never built and all the promises about bringing the farmer and the consumer together went up in smoke.

C. Franchise Frauds

Franchising is big business. In 1980, franchising accounted for more than $200 billion in annual sales. In constituted 25 percent of all retail sales and 13 percent of the gross national product.

Franchising developed when the small businessman with a popular product or service and limited capital desired to expand in order to compete with large chain operations. A small business franchise is usually a contract by which a company with a program for capturing new markets licenses an individual to operate one or more of its units within a certain specified territory. Under this arrangement, the company supposedly offers a trademarked name, a quality product, demonstrated public acceptance, operating experience, and management know-how in return for an individual's investment in locations, equipment, and supplies furnished by the parent company.

Although most franchise investments are legitimate, the lure of high profits has made them an ideal device for con men. Some franchise opportunities promise the possibility of a six-figure income. Equal to the hoped-for income, however, is the degree of risk. Many franchise investments do not earn the profit promised, and in fact lose money. Often, franchise investors are promised territorial exclusivity, which can be vital to the success of a franchise. Instead, the franchisor may deliver a market saturated with competing franchises. Other franchisors may misrepresent the nature of the business, or falsely claim that they are manufacturing and selling equipment at cost.

1. Fast Food Chains

Fast food chains are one of the most common types of franchises. The investor is promised a well-known name and product in order to establish a restaurant. The franchisor promises assistance in setting up the restaurant along with providing the necessary equipment. Often franchisees have invested substantial sums of money, only to find that the restaurant equipment is defective, that the franchisor

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stops making the product or goes out of business, or that the amount of profit has been misrepresented. The following case histories illustrate some of the problems investors have faced.

Mrs. Bayard G. Moore of McKeesport, Pennsylvania, testified before the Aging Committee on September 11, 1981, and told of her experience with a franchise ripoff:

> In the summer of 1977 my husband and I read an ad in the "Business Opportunities" section of our local newspaper. The advertisement was a solicitation for investors interested in purchasing a business franchise specializing in selling pies, tarts, and cookies.
>
> We responded to the ad and met wth the principals of the company. They made the franchise sound like a "no-lose" proposition. They assured us we had an opportunity of a lifetime—to get in on the ground floor of a franchise that would expand as rapidly and successfully as McDonalds. So, in September of 1977, my husband and I mortgaged our house and purchased a pie franchise for about $25,000.

She continued:

> The company projected an annual net profit of about $26,000. To achieve its profit, about 100 pies were to be sold daily. In the beginning, we did that. Later, as we were about to close, if we sold 10 pies we were doing good. The company promised an advertising budget of 2 percent of their gross income. At first, the advertising was provided. After a few months, the advertising stopped. We contacted the media and sought to purchase advertising out of our own pockets. We were refused and were told the company had not paid for past advertisements. After that, we were never successful in getting the newspaper, radio or other media sources to advertise for our pie franchises.
>
> The company promised to train my husband and I. They never did.
>
> What essentially killed our business was the quality of the pies the company provided. The pies delivered became increasingly poor in texture and in taste—to the point where the company, by letter, invited the franchise owners to find another supplier for pies and then close their bakery. We attempted to confront the principals with their many broken promises, but they simply refused to return our calls.

She concluded:

> I could go on and on about broken promises, but you could only get the full picture by also talking to the other 27 pie franchises in our tri-state area and dozens nationwide who invested in this scheme. Many of the pie franchise owners also were retiring and expecting to use the profits from their franchises to support themselves or their children in their retirement years. All of us were forced to close within months after opening, and we lost everything—our entire $25,000. Moreover, we are left making loan payments until 1988 of over $400 a month, because we mortgaged our house to make the investment. I know of another elderly couple in West Virginia who will also be making mortgage payments for the next 8 years. I know of yet another couple in Florida who lost everything and were literally forced to live out of their car. A younger couple, I know they paid $50,000 for the rights to do this, they never received one bit of equipment, never operated a store of any kind, the last I heard they drove up to a friend with a pie tree in Ohio, and with their children and possessions in a car, and that is all they had left.

—Mr. and Mrs. D of Ohio entered into a contract for an ice cream and frozen yoghurt franchise. They invested $9,500, based on promises that the company would assist them in setting up the business. At the time they signed the contract, the company promised to train them, help with financing, and conduct a market survey. The company failed to fulfill any of its promises, and the couple was unable to obtain a refund.

—In Phoenix, Arizona, two men were indicted for their part in using the mails and newspaper advertisements to offer exclusive rights to build and operate fast food restaurants. As part of their sales promotion, the operators represented at different times that there were from 40 to 200 restaurants open and operating at a profit; that the company was financially strong; and that the corporation was staffed with personnel experienced in the "fast food" business. In fact, there were never more than 40 restaurants open, none operating successfully. The company had been financially insolvent for three years and its only source of income had been from the sale of additional franchises.

—In Wisconsin, two men fraudulently sold pizza restaurant franchises for fees ranging from $870 to $5,910. Approximately 24 Wisconsin investors failed to have their contracts fulfilled. The operators made minimal efforts with respect to each of the contracts, subsequently claiming that the business had gone under, and left the state. An investigation revealed that the same operators had run businesses in many other states in a similar manner, and had operated previous corporations with like patterns for several years.

—Mr. S. of Connecticut invested $115,000 in the purchase of a donut franchise. He was promised that the purchase price would include the right to use all trademarks, bakery products related to the franchise, furniture, fixtures, and equipment, and the expertise of the franchisor in training, supervising and advising the franchise in the proper operation of the business. Four months after the store opened, equipment costs and mechanic wages had not yet been paid. This resulted in the repossession of the store's refrigeration unit and the placing of various mechanic liens on the property. Various pieces of equipment were never delivered, though included in the bill of sale. No supervision or training was provided. Numerous physical defects in the building were not corrected, damaging the roof so severely as to cause extensive interior ceiling leaks over food counters, donut counters, and fluorescent ceiling fixtures.

2. TRAVEL AND VACATION FRANCHISES

Travel and vacation franchises offer investors exclusive rights to sell vacation or discounted airline flights. After the investor has purchased the franchise, he or she may find that the services or rights to sell the vacations or airline flights are not exclusive. The following examples illustrate problems persons have had with buying vacation franchises.

—In Atlanta, Georgia, an operator ran a company which sold franchises to persons to sell various travel services, which would allegedly be provided by the franchisor. Victims who paid $10,000 for each franchise found the services were either nonexistent or nonsalable. Other individuals were induced to become officers of the corporation and invest $25,000 each in stock. The operator siphoned off the investments in the form of legal fees and funds allegedly expanded in the formation of the corporation. Losses reported by persons victimized through the scheme exceeded $300,000. The operator was indicted on several counts of mail fraud.

—Mr. T. P. of Oakville, Connecticut, was among those defrauded by an Atlanta, Georgia, firm which sold travel franchises. Allegedly, the company had made special arrangements which would enable the franchisees to allow their customers to buy first class accommodations at approximately half the cost of regular economy class airfare and hotel arrangements. Mr. P. invested $3,000 with the promise he would be the firm's exclusive agent in his area of Connecticut. The company failed to make good on any of its representations.

—In Jacksonville, Florida, two operators were convicted of mail fraud in a scheme to sell fraudulent vacation club franchises. Former franchisees testified that they paid $10,000 for the right to sell 100 vacation club memberships entitling the member to 10 years of annual two-week vacations in the Bahamas. They were to receive a percentage of the money they brought in. The company gave little or no assistance to the investors and did not provide advertising or sales training, as they had promised.

3. BUSINESS FRANCHISES

Business franchises involve the sale to an investor of a franchise to sell business opportunities to others. These opportunities include selling land, selling new businesses, or the leasing of businesses. Typically, business franchises involve the purchase or lease of an office and involve some type of training. Unfortunately, the franchisee often receives minimal training, finds that the business he is conducting is illegal, or finds that the office he must purchase or lease is outrageously expensive.

—In North Carolina, a man responded to an advertisement in the local newspaper and purchased two franchises. One franchise was for a leasing brokerage office for $7,500; the other was a financial brokerage office for $2,500, with a balance owed of $15,000. He was promised incomes in excess of the franchise fees as well as a buy-back option if he was dissatisfied with the performance of the franchises. He was additionally promised adequate training and back-up support in placing leasing and loan packages. Within three months, he was forced to close his offices. He received no back-up support or income, and the company refused to buy back the franchises.

—Mr. R. L. of Lower Burrell, Pennsylvania, invested his life savings of over $20,000 plus $8,000 he borrowed in a franchise selling "businesses." He was guaranteed that he could earn $30,000 a year or get his money refunded. He was also told that his would be the regional headquarters office in Pittsburgh and that no other offices would be doing business in that area. In fact, three franchises opened in the Pittsburgh area. Mr. R. L. sold only one business in six months, and the company went out of business.

—A Florida man answered an ad which said he could make up to $50,000 a year in a franchise relating to real estate investments. He invested $25,000 in a franchising fee and an additional $12,000 in rent, office supplies, and salaries. He received only one week of what he described as very poor training and $2,000 worth of office furniture. He later learned that what he would be doing in the franchise was selling land which was illegal without a Florida real estate license.

4. OTHER FRANCHISES

A whole variety of other types of franchises exists, such as tanning salons, discount stores, and mobile dog grooming units. Many of these franchisees face the same sorts of problems already discussed. Often franchisees are promised personnel, advertising, training, and supplies, none of which materialize. There are also false promises of high profits. The case histories below illustrate problems that investors have faced:

—Mr. and Mrs. X of Denver, Colorado, bought a franchise store that sold various types of discounted merchandise. During a training program for the store, costing $1,000, they were promised assistance in sales and ordering merchandise. After they purchased the franchise store they found out that the previous owners had lost $10,000 and that the owners before them had gone bankrupt. The couple began to lose more and more money and were offered no assistance. They continued to borrow money to stock the store but were getting further and further into debt. The couple then borrowed $25,000 but could not make it. Mr. X is now looking for a job so that he can pay back his debts, while filing a law suit with four other dealers who lost between $50,000 and $200,000.

—Mr. X of North Carolina was among more than 1,000 bilked by a company which sold franchises to manufacture and sell cockroach traps. Investors paid $600 for the franchise plus additional sums for materials. They were told that there was an established market for the product and a sales crew standing by to sell the product which was touted as being superior to everything on the market. They were told they had purchased exclusive rights to make the product and distribute it in the territory they had purchased. None of these promises turned out to be valid. The product turned out to be a small cardboard box which they had to assemble with a sticky non-poisonous substance attached to it. The idea was that once they entered the box, cockroaches would get caught in the sticky material. The investor made a number of these traps but the company refused to buy any of them. He tried to sell them himself at the company's suggested price of $13 each only to find a similar and arguably better product for sale in stores for less than $1. Court records place the total losses at more than $500,000.

—Mr. H. H. of Brooksville, Florida, invested $15,000 in a tire station franchise. Construction of the station was to commence approximately 45 days after the receipt of his money. Six months after sending in his $15,000, Mr. H. called repeatedly to determine when construction would commence on his station. His calls went unanswered or were not returned, and he was finally informed that the company had gone out of business and that his contract would not be honored.

—In Iowa, a mobile dog grooming business was promoted. The business involved grooming dogs and selling supplies to clientele. The franchise fee ran from about $10,000 to $15,000. The company told the individual investors that they could purchase a portion of the individual franchise. Typically, individuals could purchase 5 percent of a franchise. The company would provide a trailer-type vehicle, start-up supplies and equipment, insurance, and all other business expenses except the groomer's commission, the groomer's car allowance, and a royalty of 5 percent. The salesman represented to investors that they could expect to make a 200 percent profit on their investment and that the investment was a sure thing. Potential franchisees were also told that some units were already operating and making very good profits. All of the representations made were false. There had been no preparations for the hiring and training of employees capable of operating the franchises, and no arrangements were made with the grooming units in time to comply with the promised time periods. In fact, the business was not booming, the corporation was in financial difficulty, and the owners were attempting to convert the franchise system into a corporate system whereby the franchise purchasers would hold stock instead of the portion of the franchise that they originally owned. In many cases, the units did not contain necessary grooming supplies, and the training did not last long enough for the purchaser to become acquainted with the business. A permanent injunction was filed against the company and they were ordered to return funds to the franchisees.

—Mr. W.E.M. of Philadelphia lost $90,000 in an investment he made in a tanning salon franchise. He responded to an ad in a local newspaper placed by a Cherry Hill, New Jersey, firm which promised a prime location in a shopping center to open on a certain date and support with advertising, training and obtaining personnel. These promises fell through and the salon never opened.

—Mr. C.W. of Inman, Kansas, purchased a wood stripping franchise from a company in Atlanta, Georgia. They promised good training, unlimited advertising, monthly visits by the district representative and unlimited income. In fact, Mr. C.W. received only one week of training, received defective equipment which the company refused to replace, received chemicals which only turned furniture black and was advised to rent a building which was three times more expensive than what he really needed. The chemicals the company gave him dissolved some metals completely and destroyed wooden furniture. The company failed to give him a stain and finish rack, so his business was effectively inoperative for 4½ months. Mr. C.W. doubled his projected expenses, earned half the income projected and was not able to sell his business back to the company.

D. Distributorship Frauds

Senior citizens sometimes respond to ads which purport to offer exclusive rights to distribute a particular product in a certain geographic area. In many cases, promoters of distributorships fail to deliver on promises to provide quality products, or to find desirable geographic locations for sale of the products. Often, an investor finds that his territory is not exclusive, as claimed, that the prices for the products he is to sell have been grossly inflated, and that promises by the company to buy back the business are not fulfilled.

1. Vending Machines

Cases involving phony vending machine distributorships abound. Vending machine investments are extremely attractive to senior citizens attempting to supplement their retirement income. Advertisements promise high profits with a minimum investment and only 8 to 12 hours of the investor's time each week. Unfortunately, the vending machines are usually of inferior quality and sell at grossly inflated prices. $50 vending machines are often sold for $500. Promoters of vending machines frequently promise to provide the investor with a "professional locator" who will situate their machines in prime locations, such as airports and other high-traffic areas. Invariably, the "professional locator" turns out to be ignorant of the area, and the machines are placed in service stations beside machines which have been there for years, or in other low-traffic areas. In closing the deal, promoters promise to buy back the machines if the investor is dissatisfied. Usually, the senior citizen's chances of getting his money back from the company or making money on the machines is slim or none.

In a May 20, 1982, hearing before the Subcommittee on Postal Personnel and Modernization of the Committee on Post Office and Civil Service, Earl Sultze of Soquel, California, a 70-year-old double amputee, told of his experience with a vending machine distributorship:

> Shortly after moving to California in 1970, I was looking for some business that I could get into. I saw an ad in our local paper about the vending machine business which sounded good to me. I paid Robert Donovan, President of Certified Vending of San Mateo, California, $4,998.70 for 10 "Chocolate Shoppe" vending machines and 10 cases of candy. The purchase agreement called for delivery within 120 days or the company would be liable to a full refund plus 6 percent interest. Shipment was not made and weeks stretched into months, so I hired an attorney.

He continued:

> My attorney found that Donovan had been an associate of James Stewart Amber who was convicted of fraud in the sale of vending machines sometime in 1970. Before that, Donovan had been an insurance agent. My attorney learned that he was operating a half a dozen different enterprises of a questionable nature in 1975. We filed suit to get our money back but Donovan filed for bankruptcy on October 15, 1975, with $700,000 in unsecured claims. We heard that in 1977 he opened essentially the same kind of business and that the Federal government filed a $26,900 tax lien against him in July 1978. In January of 1979 he was finally indicted thanks to the good work of the Inspection Service of the Post Office Department.
>
> Mr. Donovan was convicted on mail fraud and charges related to the fraudulent sales of vending machine distributorships. He was sentenced to three years in jail with five years' probation provided that he make $180,000 in restitution and that he make all of his company books available for inspection.

He added:

> Court records indicate that from 1977 through 1978, operating as Sentinal Distributors, Inc. and Sentinal Vending Supply, Mr. Donovan and his associates had ripped off at least $540,000. Of 82 vending machine sales which were documented by investigators, 47 people received nothing and the 35 who did receive the machines had difficulty keeping them operating, or the locations promised by the company in its advertising and in the contract it signed turned out to be worthless. Interestingly, court records show that some of the original Certified Vending forms which Donovan had used in 1974 were used in the sales of vending machines by the successor, Sentinal Distributors.

At the same hearing, John J. O'Brien III of Philadelphia, an attorney who has represented numerous individuals who have lost money investing in vending machine distributorships, told the Committee about one of his clients:

> In one woman's case, she found the machines would not stand upright. She was told to put 200 pounds of sand in the base of each of ten machines, or one ton of sand. The woman was age 65. The locator never arrived and the ten machines sat in her apartment for over one year. She described them as soldiers reminding her of her mistake. She was finally able to sell the machines and the sand for a fraction of her costs. The Company never responded to her pleas for help.

The following examples are illustrative of the problems purchasers of vending machine distributorships have experienced. Although these cases are organized by category, they demonstrate the similarity of misrepresentations made by companies to entice potential investors:

a. Food and drink vending machines

—Mr. M. of El Cajon, California, unemployed and attempting to find work, answered an ad listed under "Business Opportunities" in the San Diego Union newspaper. He was given assurances by a company selling health drinks distributorships that they were a national company; that the machines would dispense on an average day at least a case of drinks; that he could anticipate approximately $25,000 per year profit from the operation of 20 machines; that the company would re-purchase the machines if he did not wish to stay in the business; and that the company was planning to develop a representative office in San Diego and, if he bought the 20 machines, he would have the first option to be the representative. Based on these statements, Mr. M. agreed to purchase the machines and a distributorship. To do this, he had to use his total savings, refinance his home and borrow $17,000 from his bank. The professional locator he was promised turned out to be new to the San Diego area and not experienced in soft drink machine locating. The locations he picked were poor and averaged less than seven cans per day per machine. After the company agreed the machines were poorly placed they were relocated. This time three were put in one hotel, on three different floors, but with too few rooms on each floor to expect the type of sales that had been promised. Another machine was put in a lumberyard which had just had a machine removed because it could not support the cost of servicing. Mr. M. attempted to sell back the distributorship, but the company refused, in spite of their promises to honor such requests. Additionally, they refused to relocate the machines, failed to offer him the representative position, did not service machines, and sold him machines which were at least $200 over market value. He was unable to recoup his losses.

—A California couple purchased three hot food vending machines for $2,300. They were told that their machines would be in place in about 60 days. Four months later, they had not received the machines and asked for a refund. They then received a check for the interest on their investment funds. The machines arrived two months later, but were not placed. The couple continued to write and call but received no response. Finally, they decided to put one of the machines in their living room so they could take pictures of it and try to place it. After placing the food cans in the machine in order to try it out, they discovered that the machine kept the money without pushing out the cans. The lever on the machine wasn't long enough. If the can got too close to the heater and didn't drop it, it exploded. The food could not be cleaned out. The couple is still trying to get their money refunded.

—Ms. D. S. of Baton Rouge, Louisiana, purchased 15 of a particular kind of cookie vending machine from a company in Monroe, Louisiana. The president of the company talked Ms. D. S. into borrowing $5,000 to purchase the machines and told her she would be able to pay back the loan from the projected monthly income he assured would be possible. She found that the machines were no good, that there was much delay in getting them shipped, and that no assistance was provided in locating the machines, as promised. She went so far in debt that she was unable to pay off her $5,000 loan.

—Mr. J. G. of Sellersville, Pennsylvania, invested $6,452 in a hot food vending machine distributorship. The company had claimed that an investment of $3,000 would return "$360 Net Per Week." In fact, on his investment of $6,452 (plus shipping charges extra) he netted only $30.54/week, some $330 less per week than the company had claimed.

—Mr. L. H. of Fayetteville, Pennsylvania, invested in a distributorship in which he bought and placed four hot food and four cold drink vending machines. He was assured by the company that these machines would be placed in industrial locations with sizable work forces. Mr. L. H. paid the company the sum of $8,990 for the machines and four locations. About $5,300 of this amount was for virtually worthless locations secured by the location securing agent for the company. The agent placed Mr. L. H.'s machines in auto and truck garages which were very unprofitable. His attempts to secure a refund from the company were unsuccessful.

—Mr. S. H. of Loveland, Ohio, paid $23,050 to purchase 10 refrigerated vending machines to dispense yogurt. It was represented to him that the machines were in compliance with all State and Federal laws and suitable for the purpose represented. He was to have been provided with ten high traffic locations where he could place his machines and be assured of high profits. The State of Ohio and the City of Cincinnati immediately took action informing Mr. S. H. that the vending machines were not equipped with the required safety cut off valves and were therefore in violation of health and safety regulations. He was unsuccessful in getting his money back and ultimately lost his investment.

—D. A. and B. K. of Banff, Alberta, Canada, invested $17,500 in juice vending machines. As part of the investment the company was to supply fruit juice in bottles and cans at certain prices for purposes of stocking the machines. The price of the juice started out at levels higher than had been agreed upon, and continued to climb to the point where the investors were forced to raise the price of the items in their machine. Furthermore, the coin mechanisms in the machines were faulty and could only be adjusted by a factory in Pittsburgh, which involved the shipment of the machines at a cost of $300 each.

—Ms. McEyers of Knoxville, Tennessee, invested $1,000 in a gum and mint vending machine venture. The company promised Ms. E. unusually high weekly income on a full- or part-time basis. Their advertisements suggested that the machines produced $30 to $35 a week. In fact, the machines that she purchased did not even gross $14 a week. The machine was advertised to have been thoroughly tested, well built and quality engineered. In fact, the machine was flimsy, cheaply constructed, and could be picked up by two teen-agers. The product and coins could be physically shaken out of the machine even when the base was filled with gravel. According to Ms. McEyers, the major selling point of the company was the location service they provided. The locator she received was interested in placing the machines anywhere and getting out of town.

—Mr. J. P. of Georgia invested all the money he had, $3,180, in a hot foods vending machine distributorship. Nine months after failing to hear from the hot foods company and failing to receive his machines, Mr. J. P. attempted to contact the company. He was informed that they had closed down their operation and left the state.

—A Mr. R. L. of Henrietta, New York, invested $3,210 to obtain a franchise selling hot foods in vending machines. Six months after making the investment, he still had not heard from the company, nor received any of his vending machines. However, he did receive another solicitation from a company by a different name selling hot food distributorships. When Mr. R. L. called to determine if they were the same company he had already bought a distributorship from, he was told that they were the only company selling hot food distributorships and had been since 1958.

—Thirteen investors in the state of Washington lost a total of $99,135 to a coffee machine vending company. After filing a complaint through the Attorney General's Office an injunction was filed against the company. Despite contrary representations, investors learned after purchasing the machines that the company was not competitive with other vending systems; that the dispensers were of poor quality and delivered in damaged condition; that the dispensers were sold at inflated prices; that the number of a vends per day was less than represented; and that the machines were located at inappropriate, inconvenient, low volume locations. The company refused to cancel or refund within the 60-day trial period, sold distributorships to anyone willing to purchase in overlapping geographical areas, refused to acknowledge or respond to complaints. The company was ordered to repay the investors for the full costs.

—In Phoenix, Arizona, operators pleaded guilty to mail fraud involving the sale of hot food vending machine distributorships. Customers were told that they would receive high quality machines located in populated areas and could expect at least twelve sales per machine per day. In fact, the machines were of low quality, placed in unpopulated areas, and unprofitable. 6500 hot food vending machine distributorships were sold for over $4 million. 48 people who paid $291,000 never received their

machines. The operators used some of the company's assets for their personal affairs, taking $250,000 in cash along with other funds for personal expenses.

—Mr. and Mrs. D of South Point, Ohio, and Mr. K. H. of Omaha, Nebraska, lost $4,000 and $6,950 respectively to a vending machine company based in Plantsville, Connecticut. Neither the machines nor the candy necessary to stock them were delivered as promised.

—Mr. E. F. of Virginia Beach, Virginia, lost his $6,950 investment in candy vending machines. He said that inferior machines were substituted for what he paid for without his consent; that no training was offered to him as promised; that no protected territories were offered as promised; that the locations provided were unacceptable; and related equipment was not provided. The ad promising $600 a week profits for full-time work and $150 a week for part-time work visiting and servicing the machines was a fraud.

—Mr. and Mrs. G. D. of Hamilton, Illinois, lost $8,398.60 in the purchase of ten vending machines from a Houston, Texas, firm. They responded to an ad in the newspaper promising great profits with minimum work. The firm promised to provide the machines at a certain date and the food to go in the machines. Two hot food machines, two refrigerated machines, four snack machines and two infrared ovens were ordered but were never delivered.

—Mr. J. E. of Miami, Florida, ordered 20 juice vending machines and 10 coin slots from a Nebraska firm paying $7,060. The vending machines were never delivered.

—In Denver, Colorado, an elderly woman confined to a wheelchair, answered an ad in the Rocky Mountain News involving the sale of a vending machine distributorship. She invested $6,439. She was supposed to have been given ten vending machines to sell snacks and toys. She never received the machines or the products. When she tried to contact the company, she found that the phone had been disconnected.

b. Stamps

—Mr. and Mrs. W, a retired couple, invested their life savings of over $8,000 to purchase several stamp machines from a postage stamp vending company. They were assured that the machines would pay for themselves in three years. The couple found that not only did the machines not pay for themselves, but that they had to pay out of their own pockets just to keep them operating. In attempting to contact the company, the couple received nothing but unanswered correspondence marked "moved, no address."

—In Turtletown, Texas, an elderly man lost $1,000 in a distributorship. He bought ten postage vending machines at $100 each. However, he found he was unable to sell any stamps because they were more expensive to buy out of his machines than in the post office. He tried to contact the company to return the vending machines, but found they no longer existed.

—Mr. P of New Orleans, Louisiana, recovering from a heart attack, invested over $4,000 in a stamp vending machine. After sending the money to the company, and receiving a receipt, he received nothing more. He tried to contact the company to obtain a refund, but found that the phone number he had been given was out of service and the office closed.

c. Hosiery

—Mr. L. W. of Horseheads, New York, responded to an advertisement in a local newspaper seeking investors in a hosiery vending machine route. Shortly thereafter, he invested $7,950 in ten vending machines with the promise that he would be the sole distributor in a 25-mile radius and that further distributors would not be sought for at least 30 days after the initial machines were installed. He was assured by the company that locations for selling the hosiery would be secured by a location specialist and that these locations would guarantee the sale of at least six pair of nylons per day. It was promised that nylon orders would only take three days to fill. In fact, several days after purchasing the distributorship, the company's sales representatives were again soliciting distributorships in Mr. L. W.'s area, and the locations secured by the "specialist" were poor or completely unsatisfactory. Of the ten site owners, three told Mr. L. W. that they had not given their permission to have a machine installed and said they had told the "specialist;" seven were one- or two-operator beauty salons, one was a motel where they got very few female guests, and one was a restaurant where the local manager did not have permission of the area manager and did not want the area manager to know about the installation. Mr. L. W. found that, at best, only one or two pairs of nylons in a machine sold per week, as opposed to the six a day promised. And, hosiery delivery time took three weeks rather than three days. He tried to secure a refund, but was unsuccessful.

—An elderly couple in Virginia responded to an advertisement which appeared in their local paper pertaining to the vending of panty hose. After talking to the company's sales representative, they invested $2,780 in four panty hose vending machines. They were assured they would receive appropriate training in caring for their business, and that a professional locator would assist them in securing profitable sites for the machines. They received no training whatsoever, and the professional locator secured only two of the four sites, one of which asked for the machine to be removed when it failed to be profitable as promised.

—In Dallas, Texas, three operators were convicted on two counts of mail fraud and one count of conspiracy in a scheme involving the sale of panty hose vending machine distributorships. Misrepresentations were made regarding expected profits, past business success, and support to assure success. In reality, locations of the distributorships were obscure, sales were only a small fraction of the alleged national average, the firm showed little interest in the success of vendors, many machines were not delivered, and the company would not buy back any of the distributorships. An estimated 286 victims were defrauded of approximately $750,000 in this scheme.

d. Maps

—Mr. M of Washington, D.C., invested in a motor map vending machine distributorship. For a total of $6,174, he was told that he could get ten machines, 4,000 maps, and the services of a professional locator to place the machines in high traffic locations. Mr. M received the ten vending machines but no maps. After three months and repeated unanswered calls to obtain the undelivered maps, Mr. M asked for his investment to be returned. He was advised that the company would buy back the distributorship for only 60 percent of his original investment. To date, he still has ten vending machines and no maps, and has lost a total of $6,400 including shipping and interest costs.

—Mr. T. of California met with a sales representative of a motor map vending company to discuss obtaining a distributorship. Mr. T. was promised ten vending machines, maps and professional locator services to place the machines in high traffic areas. He found that the locator services were far from professional—only five of the ten locations materialized. These locations were poor and unprofitable. He was unable to obtain a refund of his investment.

—In Ohio, a gentleman purchased three auto map vending machines. Prior to the purchase, the company made numerous promises of high sales and profits as well as the assistance of persons trained in locating sites for the vending machines. None of these promises were kept. When the gentleman attempted to return the machines and maps, did not get his money back as the company had promised.

e. Magazines

—Mr. X of Alabama purchased 20 vending machines for magazines at a cost of $21,000. After installing the machines, without the help of the company, as promised, he discovered that the openings in the machines were too large and that the customers could grab the magazines without paying for them.

—Mr. and Mrs. H. of Bartlett, Illinois, paid $5,980 for five magazine vending machines. After paying the sum to purchase the machines the couple did not hear from the company for several weeks. They were told that they had to obtain their own magazines, even though the company had previously guaranteed a supply of magazines wholesale, and that they had to help secure locations for the machines. It soon became apparent that the machines were inferior. The standard size magazines either didn't fit into the machines, or came out in twos and threes, and the coin mechanisms jammed. Hotel managers asked that their machines be removed. The couple asked for their money back, but got no response from the company.

f. Other Vending Machines: Electronic Games

—Mrs. T.P. of Raleigh, North Carolina, invested her life savings and some money she borrowed in a spray vending machine business, which she was guaranteed by the company would return her original investment within one year. If she paid for the distributorship in cash right away, she was promised her choice of locations in the Raleigh area to place her machines. The company ignored this promise. When the machines were finally located, they were located poorly. After one year, and extremely low profits, Ms. T.P. sought to return the machines and receive a refund of her money, as allowed by the company's contract. The company refused to honor this promise.

—In Indiana, an elderly woman invested $8,000 in a vending machine franchise selling "health grow." The company went out of business and declared bankruptcy. It was learned that the company was investing its money in interests outside of the company.

—In Chicago, Illinois, an elderly man invested $25,000 in 100 pen vending machines. He was promised that the machines would average sales of 50 pens a day—they actually averaged one to two pens a day. The pen company later stopped making the vending pen, and the man went bankrupt.

Pinball Machines and Electronic Games: A Special Area of Concern

For many years, pinball machines have been significant sources of income. Nor surprisingly, there have been con men who sell pinball vending machines which are subject to all the same problems outlined in other parts of this section. The following is an example of what can happen to an investor:

—Mr. L.E. of Springfield, Missouri, invested $8,700 in five Chinese pinball machines. Relying on the company's promises of high profits, few repairs, and a guaranteed refund after one year, Mr. L.E. assumed he couldn't lose. One year later, Mr. L.E. found himself making numerous repairs, locating the machines himself, and paying for the machines out of his own pocket rather than out of the profits promised. When he attempted to obtain his guaranteed refund, the company refused to remit his money as previously promised.

In recent years, electronic or video games have become an exceedingly lucrative enterprise as evidenced by the growing number of video arcades. It should come as no surprise that con men would move into this area. Indeed the Committee has received testimony from both the Postal Service and from individuals such as William Waters of San Antonio, Texas, concerning video game ripoffs. Given the growth of this industry, it is obvious that an active minority will continue to try to cash in, defrauding the unsuspecting. Mr. Waters told the Committee:

I am 61 years of age. For 25 years prior to my retirement I was in charge of distribution for a large firm which sold dairy products in the Southwest. I now work as the manager for several swim and tennis clubs.

On the eve of my retirement in November 1978, I was looking for a profession to pursue which would not be too taxing and which would afford the opportunity to make a reasonable income. I saw an add in the San Antonio Express placed by the Jurlor Marketing Corporation which held out the promise that a reasonable income could be made from an investment of coin operated video games. I called an 800 number listed in the ad and the company sent me some literature. Thereafter, they made arrangements for me to visit the company's offices in Cincinnati, Ohio. I made the visit after Christmas.

I was impressed with the possibilities and the machines. I decided to buy 6 of them at about $3,000 each for a total investment of $18,000 on my part. I gave a $1,000 deposit initially and some time in January 1979, I wired the remaining $17,000 to the company. The company was to deliver the machines in 30 to 45 days and to provide me with high traffic locations. Nothing happened.

In March, I began to make calls but company officials ducked my calls. I could never get through to the person in responsibility. In the midst of all my troubles with the firm they tried to interest me in a sun tanning franchise that they were offering. They said they would provide me the locations and the sun tanning booths and sun lamps. Of course, they wanted more money. I refused to pay more.

My son is an attorney and he did his best to go after the firm. He quickly came to the opinion that there was little chance we would ever get our money back. We wrote to the Better Business Bureau and other groups but there was nothing that anyone could do.

I was happy to hear that the two principals involved were finally apprehended and convicted on fraud charges. Each received a four year sentence. No one knows how many people were cheated out of how much money. Investigators were able to prove at least $200,000 in fraud in the trial that ended this June, but aspects of the case are continuing.

I am sad that I lost my money. The video games looked swell. Chief Postal Inspector Fletcher has shown you a picture of the type that I purchased. I know that a few people actually did get these vending machines but they were not operable. This was a classic ripoff from the beginning.

2. JEWELRY

The same types of false promises made to induce investors to purchase vending machines are used to entice potential investors in jewelry distributorships. Inflated claims regarding past business success, expected earnings and sales lure many elderly people into purchasing jewelry distributorships. Most often, the consequence of this investment is a substantial financial loss. Examples follow:

—In Little Rock, Arkansas, an operator was indicted on 12 counts of mail fraud and one count of conspiracy for a jewelry distributorship scheme. The operator falsely claimed that he was an exclusive national sales representative for a reputable, established jewelry company. Five hundred victims in this scheme paid between $3,700 and $20,000 for these distributorships.

—A Cleveland operator was convicted on three counts of mail fraud for his scheme involving jewelry distributorships. It was misrepresented to investors that the company did $4 billion sales in 1976, a 26% increase over 1975. In most cases distributorships received less than $100 worth of jewelry and no sales locations. The operator was receiving a salary of $10,000 per month and using company money for personal affairs. This distributorship scheme victimized 540 persons in 40 states of approximately $3.6 million.

—In Hartford, Connecticut, two operators fraudulently sold jewelry distributorships. For $3,474, an investor expected to receive five jewelry showcases, 100 pieces of jewelry for each showcase, high populated areas, and a projected 20 sales per week per showcase. Some people did not receive their merchandise; some had not received their locations, and those who did receive the locations did not have high traffic areas. No one made 20 sales per week per case. Most people received only two to three sales per week. Approximately 160 complaints were received involving $600,000. The company was disbanded, but the operators continued selling the distributorships under a different company name. Approximately 170 complaints totaling $700,000 were received from this company's investors.

—Mrs. P of Glen Burnie, Maryland, responded to an advertisement which appeared in a local newspaper soliciting distributors in many lines of business. She agreed to purchase five displays at a cost of $235 per display and $460 worth of jewelry to go with each display, on the understanding that the company would buy back the displays and/or merchandise at the end of 12 months if she so desired. Following the purchase of the distributorship, she was informed that the price of the jewelry had increased, so the company simply sent her less jewelry when her order was filled. The company failed to secure locations for the displays, and would not refund her money, as promised.

—Nita Brumley, a retired nurse from Lubbock, Texas, submitted the following statement to the Aging Committee on September 11, 1981, concerning her experience with a jewelry distributorship:

I was looking for part-time work that I could do during my idle time. I answered an ad in our local paper placed by Investment Services International. The ad promised that several thousand dollars could be made working part-time selling jewelry.

In answer to the ad, a meeting was set up between myself and a company representative at a local motel. He told me I needed to give a deposit of $695 on the spot and that if I were accepted by management, I would be required to give an additional $2,780 for a total of $3,475.

For my money I was to receive five jewelry showcases, a hundred pieces of costume jewelry for each showcase, high traffic locations for the showcases and a projected twenty sales per week per showcase.

Even though it constituted a good chunk of the money that I had set aside for retirement, I made the investment after checking with the Better Business Bureau (BBB). I was to learn later that the company had paid an insider at the Hartford BBB who sent letters of endorsement for the company to affiliated offices throughout the country.

Needless to say, I lost all of my money but I was in good company since about a thousand people nationwide had been taken in by this scheme which ran for six months in 1978 and then collapsed like a house of cards. I testified at the trial some months ago and learned total losses may approximate $2 million. Like me most investors received nothing for their money.

3. VITAMINS AND HEALTH AIDS

As a result of increased awareness regarding the benefits of physical fitness and proper nutrition, distributorships selling vitamins and health aids are becoming more prominent. Prospective buyers are promised high earnings, numerous buyers, advertising and other promotional assistance, and guaranteed buy-back provisions in the event the investor becomes dissatisfied with the venture. In reality, many of the products are of questionable quality, investors do not come close to earning the profit they were promised, advertising seldom materializes, and no refunds are given.

—In La Jolla, California, two operators were convicted for selling distributorships involving Solorama Boards and Diasyne Pads that allegedly emitted negative ions which, when absorbed by the body during sleep, would aid in the relief of pain, tension, insomnia, and migraines. Promoters represented that the corporation had 63 years of experience; however, the corporation was in existence for less than one year. Promoters promised possible earnings of $40,000 per year. In fact, no one remotely approached that advertised earnings figure. The corporation claimed to have more customers than people to service them; however, there were no customers ready to purchase the product. The company said that it had a no-risk, 100 percent buy-back program; however, it refused to buy back any products. Radio, television, and newspapers advertising was promised. In fact, no advertising or merchandising plan existed. Sixty-three victims were defrauded of over $307,000.

—A West Virginia man purchased a distributorship for $9,900 to sell pharmaceutical products to ten stores. Agreements between the company and the stores were to be arranged by the company so that the distributor would only have to supply the necessary goods. After several months, the gentleman received a few of the promised products, but the company did not establish any of the outlets. The gentleman contracted a lawyer to try and obtain his money back.

—A company marketing skin care products sold distributorships for $4,600 to four couples in California. The couples were told that the distributorship would be limited to one for every 200,000 people, but later the company changed their policy and allowed one distributor for every 25,000 persons. The products sold to the distributors were priced above the suggested retail price. With the high mark-ups, the distributors found it impossible to sell the products. Distributors were also asked to buy a $300 sales kit that contained no brochures, no charts or graphs or visual aids to help sell the cosmetics. The couples tried to get their money refunded but were unsuccessful since the company did not respond.

4. HOME AND BUSINESS PRODUCTS

Promoters of some home and business product distributorships, like promoters of nutrition and health aid distributorships, promise a lot, but deliver little. Essentially, these promoters of phony home and business product distributorships promise high profits, quality merchandise, guaranteed customers, assistance in selling the product, and oftentimes the guaranteed buy-back of products if the investor becomes dissatisfied. Usually, investors fail to receive the products they purchased. In cases where the products are received, they do not meet the standards the promoters promised. Seldom does the company secure customers or provide a product that is highly marketable. Phony home and business product distributorships range from illegal fishing tackle and incentive roach killers to wall clocks without hands. The following are some selected case summaries illustrative of home and business product schemes:

—Mr. and Mrs. G. S. of Halifax, Pennsylvania, answered an ad in "Fishing Facts" magazine about a fishing tackle dealership owned by a company out of Nebraska. After meeting the president and vice president of the company and reviewing their literature carefully, Mr. and Mrs. G. S. agreed to invest about $11,000. Later, Mr. and Mrs. G. S. discovered that many of the promises and statements made to them by the company representatives were false. The company guaranteed their money back if the business failed, yet after their business did poorly no money was returned. The company guaranteed that the fishing tackle would sell or could be exchanged for items that would sell. However, tackle that did prove to be inappropriate for the area was not accepted for exchange. The company guaranteed that they had computerized systems to locate the hottest lures for fishing. In fact, they had no computer system at all. The company promised to send monthly reports and news updates regularly. Mr. and Mrs. G. S. never received any of this literature. The company promised to provide advertising in national magazines. No such advertisements appeared. The company stated that they had the lowest price available for tackle equipment. The couple found others in their area with lower prices. The company promised market research to determine which lures were best for their area. The market research provided them with a shipment of tackle illegal in Pennsylvania. The company locator for the tackle racks promised location owners high returns for stocking the racks. In fact, the racks were poorly received. The company promised credit for damaged items shipped through the mails. When items were returned for credit, a 25 percent restocking fee would be levied against the couple. The company promised all brand-name tackle. However, many of the items received by the couple were simply junk and not brand-name tackle. When the couple tried repeatedly to contact the company to describe the abuses and the poor operation of the business, they were told that the president and vice president they had worked with and who brought them into the business were no longer with the company. Their calls are no longer being answered at all.

—Mr. F. J. of Mechanicsburg, Pennsylvania, after reading an ad seeking persons to invest $9,500 to become an associate of a company in the Harrisburg-York-Lancaster area, arranged to meet with the company's sales representative. The representative explained to Mr. F. J. that he had the opportunity to invest in a respirator distributorship. His initial investment of $9,500 would purchase 10 respirators, which he would then be able to rent out at $65 per month to persons covered by Medicare, implying his investment would be secured by the U.S. government. The company, at their own expense, would fly Mr. F. J. and his wife to Ft. Lauderdale to undergo company training covering all aspects of the business. The major selling point of the company was its agreement to furnish Mr. F. J. with his first 10 chronic lung disease patients, thereby ensuring him that he would make his investment back within two years even if he was never able to get more than 10 patients. Only one patient was ever secured for Mr. F. J. The company suggested that he secure the remaining nine himself. Mr. F. J. unsuccessfully attempted to obtain a refund from the company.

—R.A.A. of Bay Village, Ohio, lost $1,556 answering an ad for investment in pizza ovens placed by a Baltimore firm. The company kept the money, never delivered the five ordered ovens, and immediately went out of business.

—Mr. B. H., a 73-year-old retiree from Alamogordo, New Mexico, living on Social Security, borrowed money to invest in a distributorship selling roach killing traps. Each trap consisted of a small cardboard box which contained a harmless, non-drying, sticky substance and a non-poisonous bait which resembled dog food. A set of two retailed for $3.98, leaving a net profit of $3.28. About 20–25 traps could be made per hour on the kitchen table. Claims of the high profits that could be expected from selling these traps proved to be false. The sticky substance soaked through the assembled traps after several days, making them look soiled. If the substance got on clothes, it was impossible to remove. Mr. B. H. began to give some of the roach killing traps to friends, who reported they did not kill roaches. Mr. B. H. himself only caught one roach using his method. When he attempted to obtain a refund on his investment, the company refused.

—In Lubbock, Texas, two men were indicted for selling nonexistent bottled water dispensers through the mail to residents of three Texas cities. The men formed a corporation to contract for the sale of water dispensers and to allow clients to invest in the purified water business. Potential customers were promised free installation of the dispensers on location within 90 days of the purchase date, with a guarantee of full refund if the machines had not been delivered within 180 days. Clients were guaranteed a monthly income of $300 after the dispensers had been installed. The company failed to deliver the dispensers and failed to make refunds requested by customers.

—Mrs. P.M. of Laramie, Wyoming, invested $225 in a distributorship selling pet and people tags. She was promised by the company that she would be the sole distributor in the state of Wyoming, that TV advertising would be provided to promote the product and that she would be able to obtain a refund if the product didn't sell. Several months later, she learned that another distributor was set up in Wyoming, there wasn't any national advertising, nor would the company refund her money when asked.

—A retired military couple in New Jersey invested over $4,000 in a distributorship selling photo plaques. For this investment, the company told the couple that their distributorship would be exclusive for their area. The couple was told they would only be given one day to decide whether they would like to make the investment. They were also assured by the company that they would receive all their displays, which would be located for them by a locator specialist within two weeks. Three months later, the couple had received only partial delivery of their displays, some of which were badly damaged or simply unusable. They also learned that they were not the only distributor of the photo plaques in their area. They were unsuccessful in their attempts to obtain needed repairs, products, or a refund of their investment.

—A Missouri couple invested $2,000 for a distributor to sell lighters at retail stores. The total cost of the distributorship was $4,000, but the couple only made a 50% deposit. After giving the money to the salesman they heard nothing for three months. Later, they were contacted by the salesman who said that they couldn't get their deposit back, but that they could get the units if they invested the remaining $2,000. After contacting the company directly, the couple found out that the salesman was a con man and that they had lost their $2,000 deposit.

—Mr. X of Wisconsin invested $4,500 with a company for a distributorship which would allow him to sell a line of cypress wood products to furniture and gift stores. After two months, the only shipment that the gentleman received was a box of wall clocks without hands.

5. OTHER DISTRIBUTORSHIPS

Although the aforementioned distributorships are those most commonly marketed, distributorships are devised and sold to market just about any product imaginable, including but not limited to auto parts, greeting cards, toys, photographic equipment, clothing, motivational materials, nylons, and cleaning equipment. A sampling of case summaries involving persons who have been victimized by a variety of other phony distributorships follows:

—A Mr. S of Tennessee invested $3,795 in a Texas firm which claimed its product could be placed on black wall tires to convert them into white walls. Mr. S found that this claim was totally false. When the product was applied to tires it turned them brown or yellow. The Texas firm refused to return his investment or to admit fault.

—Mr. H. became a distributor for an oil company, selling their products to new and used car dealers. He invested about $15,000 in advertising through radio, TV and newspapers to make people familiar with the products. He hired several employees and tried to build up a name in his territory. After the investment, the oil company took away his distributorship and refused to let him sell any products. Instead, they gave his accounts to other salesmen.

—An elderly man living in Indiana saw an ad for an igniter distributor ship. According to the ad, igniters would allow a car to get more horsepower, while saving up to 8 miles per gallon on gas. The man sent in $500 for the igniters. After repeated calls, he finally received a box of 30 igniters. He tried to sell them, but found that they were defective. Some of the igniters burned out after 50 miles. The man sent them back, but failed to get a refund.

—Mr. A.R.L. of Graytown, Ohio lost $5,550 to a Chicago, Illinois corporation which placed an ad encouraging investment in what was described as a unique opportunity. The product to be distributed was a compressed gas tire inflator. It was hardly unique; moreover, it was overpriced. The investor was expected to charge $9.95 for a 12-ounce aerosol can. The investor learned to his chagrin that a similar product was available in area stores at a price of $1.07 per 12-ounce can.

—A North Carolina gentleman decided to become a distributor for an auto product that would seal punctured tires. He ordered a $500 shipment of the liquid, a $288.96 promotional package and a $79 promotional tape. He was assured that the merchandise would be sent freight prepaid. Upon receiving the merchandise, he found that the shipment was freight collect, and that some of the ordered items were not sent. He contacted the company, which assured him that the remaining items would be sent shortly and that he would be reimbursed for the freight charges in the next shipment. He received no further word from the company despite repeated efforts to contact them. Realizing that he couldn't do business with the company, he packed up all the equipment and sent it freight collect, but it was refused. He then received a letter from the company telling him that he was not authorized to return the merchandise.

—Mr. and Mrs. P.F. of Whitesboro, New York, responded to a newspaper advertisement in which a company claiming to be a manufacturer of precut clothing kits offered to all interested parties the invitation to become a sewing dealer with exclusive sales and distribution rights throughout the Northeastern United States. In June 1979, the couple signed a contract with the company and received a partial shipment supposedly worth approximately $4,000. The couple discovered the merchandise to be shabby and faulty. Mr. and Mrs. P.F. made numerous unsuccessful attempts to reach the company. The last two phone calls they made were answered by another company, a toy company. Mr. and Mrs. P.F. subsequently learned that approximately 30 or more individuals in their area were conned by this company.

—Mr. J.J. of Chicago, Illinois, applied for a distributorship to sell panty hose. For the application, he paid $200 in cash and then a balance of $1,795. He was to receive the merchandise, the displays, and five stores where he could display his merchandise. The locator gave Mr. J.J. a list of stores he assured him would display his nylons. Upon contacting the location owners, he found that some of them said they already had too many panty hose and to come back at a later date; others said that they had not signed any agreement; and another said they were moving to Florida soon. Mr. J.J. paid cash and received nothing. He tried repeatedly to contact the company and receive a refund of his money. He was unsuccessful in his efforts.

—Mr. R.C.G. of Bridgeport, Ohio, lost $3,995 in a fraudulent distributorship to sell Kodak film, flash cubes and other photographic supplies. The company, based in Des Plaines, Illinois, had promised to provide training, promotional material, racks in choice locations, permission to leave such racks in various retail establishments and film at wholesale prices. None of these promises were kept. Mr. G. could not get his money back because the company went out of business.

—After attending an "Own Your Own Business Show," a couple from Kansas bought a musical greeting card distributorship. The distributor price included 11 racks, 4,400 musicards, 11 record players, plus 11 locations for the 11 racks, totalling $7,240. They were promised the cards would be in their locations by Thanksgiving and making profits by December. Each rack was promised to sell 40 musicards per week, or a new location would be found. They were never assisted in obtaining locations, but set up three of their own. One location sold six musicards in six months, another sold 24 in two months, and the third sold 80 in one month. The musicards they received were not of the quality promised. They were inferior in tone and skipped. The company never returned any of their numerous calls.

E. Commodity Frauds

Commodities swindles have become one of the biggest consumer frauds in years. Government investigators estimate that commodities schemes are defrauding the public of as much as $1 billion a year. The term "commodities" refers to a wide range of investments, from metals and gems to wholesale food products and foreign currencies. Although most firms are reputable, there are a growing number of illegitimate firms who illegally sell off-exchange investments to the unwary. Commodities investments are a perfect vehicle for swindlers, since the payment of profits to investors is usually deferred for six months to a year, leaving plenty of time for the operators to skip town before any of the profits become due. Furthermore, since commodities are by nature a very complicated and risky investment, many investors are never sure whether they have been cheated or not.

There are two basic ways to invest in commodities. The first is to pay the full price and take immediate possession of the item. The second is to buy on margin, which involves putting up a percentage of the total purchase price with the balance being due on a predetermined future date.

Typically, commodities schemes involve a "boiler room" operation, which is a room full of telephones in which 10 or even 100 salesmen make "cold calls" to people who responded to newspaper advertising. These salesmen are paid by commission, and high pressure sales are the name of the game. In many cases, a sale is consummated on the phone. If the person called doesn't agree to purchase anything in the initial call, he or she will be inundated with literature and harassed until a sale is made. The salesman usually requires the deposit to be wired from the investor's bank, leaving no time for second thoughts.

In a September 11, 1981, hearing before the Aging Committee, Earl Wilt, a convicted felon currently serving time for perpetrating a commodities fraud, offered to conduct a typical boiler room sales pitch with Members of the Committee:

Mr. WILT. Good morning, Mr. Pepper; is this Mr. Pepper I am speaking to?

The CHAIRMAN. Yes, it is.

Mr. WILT. How are you this morning, sir?

The CHAIRMAN. Well, I am quite all right; thank you.

Mr. WILT. Fine. Do you remember, sir, that, oh, about maybe 2, 3 months ago I called you on the phone and I was telling you that in my expert opinion that the price of gold was going to rise?

The CHAIRMAN. Yes, I do recall your conversation.

Mr. WILT. Fine, sir.

Sir, I have an apology to make. I don't know why you and I didn't speak a little bit longer and little bit more in detail because I have calculated, sir, since three months ago that had you been involved in the gold market you would have made approximately $30,000 to $40,000. But I am not going to let that happen again, sir.

You have been following the gold market and you realize that the gold market is going to continue to rise, perhaps to as much as $1,000 an ounce in the next year or two. Right now it's selling at $240 an ounce.

Before I take too much more of your time, sir, what I would like to do is I would like to send you off some literature that will explain in detail the history of the gold market, the advantages of buying and selling or owning for posterity, if you will, gold.

However, I've got to ask a question. Sir, when I spoke to you before you said to me that well, give you a call back if gold moves. Well, now I am calling you back now and I don't want to call you back in 6 months and tell you that you lost another $30,000 because you didn't involve yourself.

Do you have between say $5,000 and $10,000 that if I could show you, if I could prove to you that I could take that $5,000 or $10,000, invest it for you in the gold market, that within three months I could double or possibly triple your money; do you have that type of money to invest, sir?

The CHAIRMAN. Well, I guess I could get up that amount if I really were persuaded, as you say; that it would make me that profit.

Mr. WILT. Thank you, sir. Rather than taking up any more of your time right now, sir, I am going to send this literature off to you. You should receive it in a couple of days. I will get back to you sometime next week. I hope I am not too late; but I will get back to you sometime next week and we will further discuss it.

Mr. Wilt went on to describe the technique salesmen use to intimidate bank clerks into making wire transfers on the client's account at once before the client could figure out what happened and stop the transaction. It goes without saying that commodities issues are fairly complex and that even well educated individuals can fall victim. Mr. Wilt went so far as to state that there were certain clients of preference including physicians who were targeted by commodities con men and that certain areas of the country notably the midwest and the far west were more easily "mined" because as he expressed it, people there are more trusting, less cynical.

There are a wide variety of commodities schemes. A modest number of examples are reprinted below:

Mr. James W. Goar, age 67, of St. Paul, Minnesota, submitted the following statement to the Committee:

Sometime in early 1978, I saw a television ad placed by a firm called Federal Gold and Silver. The company's chief executive officer appeared with stacks of gold coins in front of him talking about the escalating value of gold. I looked up the company and found an ad in the yellow pages of our phone book. I made inquiries and they appeared to be a legitimate firm.

I placed a phone call and talked with a salesperson about this opportunity. I told him that I was going to be 65 in December and looking forward to retirement. I told them I wanted to buy 50 gold Krugerrands which were selling for about $100 apiece at the time.

He continued:

The coins were delivered to my bank which increased the firm's credibility with me. Within hours of their delivery I received a call telling me that the price of gold had gone up and that my investment had grown by this and such. I was told the gains I made were being reinvested to buy more gold. When the price of gold began to tumble, I received call after call telling me I had to come up with so many thousands of dollars or lose my entire investment. I was hard pressed to meet these payments. A couple of times the company let me give them postdated checks which I issued with the expectation that I would soon have money coming in. On one occasion in asking me about any resources which I might tap they inquired if it was true that I was the custodian of my 92-year-old mother's estate. I said yes. They suggested that I "borrow" some of her funds to make the payments. I indignantly refused. I tried to sell out many times but was not permitted to do so.

To make a long story short, the firm and its principals were indicted for fraud. Several hundred people were taken for $2.5 million. The firm had not purchased gold as we had been led to believe. The principals were found guilty and sentenced to ten years in jail in February of this year. I lost $60,058 which constituted the entire total of my retirement fund. If I had been dealing with a reputable dealer, I would have made ironically $2 to $4 million. As it now stands, I have lost my pension fund and I was forced to go back to work.

Mr. Sidney O. Marcus, Jr. of Lusby, Maryland, a retired oceanographer who worked for the government, told how he was taken in a commodities scam. In his statement, he told the Committee:

My troubles began in November 1979, after I read an advertisement in the Wall Street Journal by First Guaranty Metals Co. for the sale and purchase of precious metals. I telephoned a Boston office salesman for the company. It was during this initial conversation that the salesman informed me that my only costs in buying and selling silver and gold would be commissions of 1½ percent for getting "in" and 1½ percent for getting "out" of the market, plus the interest on my investment. The contract would last for 25 years. In addition, to reassure me, he told me untruthfully that First Guaranty maintained its own inventory of precious metals, transacting two billion dollars' worth of business annually.

After having inspired my confidence and with the assurance that First Guaranty was an established and reputable company, I invested approximately $9,000 for the purchase of silver and gold bullion during a time when prices for both had been experiencing appreciable increases.

On December 15, 1979, in another telephone conversation with the Boston salesman, I was told that First Guaranty trades in the Chicago market, a statement I shortly thereafter found to be totally untrue. During this conversation my suspicions were initially aroused when he also informed me that I could not establish First Guaranty's repurchase price, through whom I had to sell, because First Guaranty figured its own market prices, despite the fact that he maintained that the company traded on the Chicago market.

On December 21, 1979, First Guaranty's scheme of fraud and deceit started to become quite apparent when I ordered the sale of 80 ounces of gold, from which I should have received $10,000. When the Boston salesman transacted my sales order, he related that I should receive my cash in five working days. Not only did I not receive the $10,000 due me within the five-day limit stipulated in our contract, but I have, to this day, never received any of it. After five days, I threatened to go to the CFTC, but the Boston salesman told me to first speak with the company's attorney in Florida. When I did, the lawyer told me he did not understand why I had not received the money and to call back in a couple of days. I felt it should have been his responsibility to get back to me. But I called the lawyer back on December 31, when he related that wildly fluctuating markets had delayed my cash payment and made me susceptible to a margin call. This seemed quite implausible to me because my current equity position of 32.2 percent seemed an adequate cushion, being more than 25 percent above the seven percent limit for margin calls, the company's policy.

He went on:

On January 15, 1980, my problem became compounded when I ordered the sale of 4,000 ounces of silver. It was at this time that what the Boston salesman had told me on December 15 about First Guaranty establishing its own price really hit home.

My sales price was to be $5 less than the price First Guaranty established as its current sales price to prospective purchasers—an excessively high bid-cash spread which was never previously disclosed to me.

Even at this reduced price, I should have received $15,000, making my equity approximately $40,000, a 19-percent position and well above the required seven-percent margin limit. Not only did the money fail to arrive once again in the five-day working limit, but the Boston salesman also told me that I might receive less than the $15,000, depending on how the Miami office figured it.

Of course, neither the Boston salesman, nor an unnamed salesman in the Miami office, could explain to me how the price spreads for my resales were derived. They both admitted they did not know, and neither one made any effort to find the answer for me.

On January 22, 1980, I called the Miami lawyer, insisting on adhering to the five-day contractual limit, but he just put me off by saying here was a backlog of paperwork. On January 24, another call to the Miami lawyer produced the same irrational and fraudulent ploy which affected my gold transaction—nonpayment of cash due to wildly fluctuating markets which threatened me with a possible margin call.

In one of my January conversations with the Boston salesman, I was told that CFTC agents had visited First Guaranty around the first of the year, and that the company was glad to have the CFTC visit and inspect because the company frowned on shady or illicit business and was glad to have a strong regulatory agency. The Boston salesman further warned me against dealing with so-called boiler room operators.

He concluded:

I understand that on June 12, 1981, the Commodity Futures Trading Commission obtained a permanent injunction against the officers of First Guaranty Metals and its parent company, Trending Cycles. The CFTC says that the firms ran an elaborate boiler room operation based in Miami and Boston and that the offices marketed so-called leverage and cash forward contracts through the use of long-distance telephone solicitations and the mail which were false, deceptive, and misleading. They said the firm targeted unsophisticated and unknowledgeable investors, while omitting material facts in their sales pitches. For example, CFTC said that the officers failed to inform customers that the firm sold commodities at one price and bought them back at a second price which was always lower, often significantly lower than the original selling price. This is exactly what happened to me. The court appointed a receiver and sought to bring about the disgorgement of unlawfully obtained profits. Some 800 other people were taken, and total losses may approximate $10 million. My investment was $9,000. My personal loss was about $58,000 . . . If I had been dealing with a reputable firm, my profits could have been this amount or more.

Ms. Pauline Hazebrouck, a 67-year-old widow from Woonsocket, Rhode Island, testified before the Senate Permanent Subcommittee on Investigations on February 23, 1982:

In the winter of 1980, I answered an ad in a magazine relating to investing in commodities. I was interested in seeing how people made money, so I sent in the card. I made a telephone call to International Precious Metals Corp. and spoke to a salesman. He convinced me to buy a leverage contract for $5,000. He spent some time explaining what a leverage contract was, and I finally agreed to the sale. I said an additional $5,000 for margin calls. Eventually I got a check back for $2,600 but the salesman called me back trying to resell me. I remember him using the line, "Just because you've had a car accident doesn't mean you don't drive anymore." I did not buy any more contracts from him.

In December 1980 I received a phone call from another salesman representing the firm First Commodity Corp. of Boston. It took a couple of calls to convince me to invest. I finally bought a $4,000 futures contract in gold, and I was also put into other commodities like wheat and copper. I eventually lost $3,800 of my $5,800 investment with them.

She went on:

While I was still involved in the copper, I received a call from a salesman who represented Prime Precious Metals Co. He called many times and kept explaining to me how I was not making money with First Commodities of Boston. He promised to make money for me, so I bought two 500,000 Mexican pesos contracts for $2,988 each. He told me I could make a lot of money and convinced me that I should get out of the copper contract with FCCB.

After my initial investment with Prime Precious Metals, I stopped hearing from that salesman and began hearing from another salesman named Toni Hunt. Mr. Hunt represented Premier Precious Metals Co. which took over for Prime Precious Metals. He proceeded to smooth talk me into purchasing four different contracts for silver and copper.

During the one-month period where I bought the four contracts from Premier Precious Metals, Toni Hunt convinced me to borrow from my certificates of deposit and even from my sister.

During the next two months, Mr. Hunt kept changing firm names, but continued to sell me various strategic metals. He sold me two contracts in manganese and cobalt while working for Prime Strategic Metals, and he sold me cobalt and germanium while employed with Prime Strategic Metals Internationale. On one occasion, I changed my mind about buying a contract, and Mr. Hunt told me I had no choice. He said I had to pay or I was in default. I had asked him what he meant, and he said he was telling me in a nice way that I had to pay. I also bought my last contract from Toni Hunt which was for manganese, and he was operating SMI Funding Corp. In total, I made 13 separate investments with these firms totalling $88,122. I have never seen any of the money from the investments beginning with the Mexican pesos.

She continued:

All of these contracts were for 12- and 15-month delivery dates and, up until this point, only one contract is about due. This contract was the first for Mexican pesos and was scheduled for settlement on February 22, 1982, which was yesterday. I received a letter in the mail dated January 24, 1982. That letter suddenly asked me for delivery instructions and that I would be charged interest of 10 percent on any unpaid purchase price. The letter was signed by Mr. Terry Ziegler who was named as the president on the letterhead of Prime Strategic Metals Co. I ignored the letter as I found out in September or October of 1981 that Toni Hunt had disappeared, and then I began to investigate the firm.

I contacted the CFTC in Washington and was told that the firms were under investigation. I realized then that I had lost all my money.

Mr. Frank R. Weichowski of Crum Lynne, Pennsylvania, had the following experience with a commodities scheme as described in his statement to this committee:

In November of 1979, I answered an ad in the Philadelphia Inquirer which had been placed by Domestic Oil Corporation of 67 Wall Street, New York City. The ad said something like: Exxon Is Making Money, Mobil Is Making Money in Black Gold, Why Shouldn't You? I sent in the coupon provided in order to learn more about the investment opportunity. I did not include my phone number.

However, I soon received calls from a company salesman who sold me on buying one unit of crude oil on a six-month contract. They said one unit consisted of 1,000 barrels and that the price was $8,950. They told me I should be able to double my money and emphasized that the price of oil was going up and would probably go up much higher because of the crisis with Iran. They told me I could get my money back any time I wanted by liquidating the contract. I was left with the impression that my money would be pooled with that of others to buy crude oil which would be sold at a profit on the Spot Market, and that we would all share in the profit.

At the salesman's insistence, I wired $8,950 to the company's account with the Sterling National Bank and Trust Company of New York on December 5, 1979. On December 12, I received an acknowledgement showing I had purchased a contract for 1,000 barrels of oil at an aggregate cost of $42,850. My deposit of $8,950 was shown as a separate fee and a balance that I owed was shown at $33,900. I was flabbergasted.

I went to see a lawyer who told me that I had purchased a contract for deferred delivery of crude oil and that my $8,950 was a non-refundable fee which was, in effect, the salesman's commission. I had the right under my contract on June 5, 1980, to purchase and take possession of 1,000 barrels of oil, provided that I paid the company $33,900 on that date. Then presumably, I could sell these 1,000 barrels on the open market for a higher price and make a profit. The attorney told me that oil would have to go up to $43.10 per barrel on the Spot Market in order for me to break even and offset the effect of the $8,950 fee that I paid. I figured I had been had. I complained to the New York and New Jersey Attorney General Offices.

On July 6, 1981, a Federal District Judge confirmed and adopted a magistrate's earlier findings that 67 defendants including Domestic Oil Corporation, and their OPEC American Petroleum, had engaged in selling off-exchange crude oil futures contracts in violation of the Commodity Exchange Act. A total of 30 companies were involved in the scheme and 37 individuals located in the United States and Panama. The CFTC found that these individuals illegally sold crude oil contracts, used false and misleading sales and promotion material, failed to disclose adequately the risk of the transactions and willfully deceived, cheated and defrauded their customers. The CFTC worked with the New York Attorney General's Office. Attorney General Robert Abrams described the scheme which operated in eight states and one foreign nation as a high pressure national boiler room operation. He said he had obtained assistance from 31 states in the investigation. "It appears to be one of the largest potential frauds my office has investigated in decades," said the New York Attorney General.

To date eight people have pleaded guilty to criminal charges and have been sentenced to terms varying in length from one to four years in jail.

IV. ANALYSIS OF U.S. POSTAL SERVICE EFFORTS TO ELIMINATE BUSINESS FRAUDS AND OTHER SCHEMES

The U.S. Postal Service has been in existence for over 200 years. There is no doubt but that it provides an invaluable service. Last year the Department was responsible for delivering over 100 billion pieces of mail and it generated a cash flow of $18.5 billion, utilizing a total of 650,000 employees. Within the Postal Service is a small group of 2,000 inspectors (the Inspection Service) who are responsible for the security of the mails, protecting, for example, against the loss of billions of dollars of negotiable social security checks. The Inspection Service is also responsible for keeping the mails free of non-mailable matters such as guns and explosives. It spend about 25 percent of its time trying to prevent mail fraud including the offering of phony investment and business opportunities.

The Inspection Service enforces the mail fraud statute which has been in existence for more than 100 years. The statute says that anyone using the mails for purposes of perpetrating fraud is committing a Federal crime which is punishable by 5 years in jail, a $25,000 fine or both.

The Committee on Aging first became interested in the work of the Inspection Service in the course of an investigation into medical quackery. The Committee found that the mails were increasingly being used to market questionable "cures" and health care products. Moreover, it was learned that fully 60 percent of all medical quackery is directed at the elderly. In the course of this investigation, the Committee and its staff conducted a fairly detailed study of the Inspection Service. The Committee learned that the 2000 Postal Inspectors are highly regarded in law enforcement circles. Several United States Attorneys or Assistant United States Attorneys went to great lengths to describe the effectiveness and professionalism of the Inspection Service.

Postal Service Inspectors are the Federal experts on fraud. Whenever Federal law enforcement personnel gather, inevitably, someone from the Inspection Service will be brought in to discuss the elements of fraud and how to make a fraud case under the Federal statutes.

In addition to business frauds postal inspectors have been successful in bringing literally hundreds of cases every year. Here are a few of these successes:

—The Service helped to obtain a conviction against a man who promoted a guaranteed cancer cure which consisted of injectible bottles full of seaweed, vitamin B–12 and large doses of poisonous bacteria. The kit cost $700 and came with several hypodermic needles. Medical experts testified at the trial that illness or death could have resulted from the injection of this concoction into the blood stream.

—The Service was able to stop the sales of a scheme which claimed to cure glaucoma, near and far sightedness with eye exercises.

Senior citizens were told to discard their glasses and glaucoma medicine and to begin a regimen which included such destructive things as looking directly into the sun. Sadly, similar schemes are continuing in other States and even though the scheme is identical, the Postal Service must show fraudulent intent in each case before the scheme can be stopped.

—The Service has blocked the sale of pills and products which were sold with the representation that they would restore sexual potency in men of any age.

—Phony arthritis cures from water said to be from Lourdes which is really from a pond in California and has no curative powers, to cod liver and orange juice mixed with cereal concoctions have been removed from the market. Similarly, phony prostate cures made up of bee pollen, zinc and pumpkin seeds have been banned.

—The Service blocked a scheme which advertised guaranteed weight loss of 30 pounds in 30 days. One ad brought in 5,000 orders a day at an average price of $22.50 each. In other words, the scheme was bringing about $112,000 a day. The promoters only costs were for the ad and for a brochure which described the taking of vitamins and common exercises.

—The Service also has jurisdiction of mail fraud in the interstate sales of land. We recently learned of a man who was taken for some $30,000 which he had received as part of his reparations for being in Dachau, the German concentration camp, by promoters who sold land in Florida which was uderwater.

—The Service has also made criminal cases against insurance agents who have defrauded the elderly by the sale of multiple, duplicative and therefore worthless health insurance policies in supplementation of Medicare. In a recent Massachusetts case, they discovered several senior citizens who had spent $40,000 or more for such worthless insurance. One woman of 93 had been sold maternity insurance; the names of other seniors were forged by means of tracing boxes on policies they had never ordered. At the same time, the Service has helped the insurance companies make cases against ambulance chasing attorneys or employees who seek to defraud the company on phony disability claims.

—Another pernicious scheme involves sending businesses invoices for advertising space which they allegedly have taken out in various minority oriented publications. The business had not agreed to take the ad in the first place but many feel they must pay rather than risk bad publicity. If a publication is received, it generally is nothing more than a list of those who fell victim to the scheme. Similarly, the Inspection Service has blocked several phony gift service rackets. These involve operators who read the obituaries and upon learning of a death, send invoices representing overdue bills to family members allegedly for gifts purchased some time before by the deceased.

—Finally, the Service has been effective in helping to develop Medicare/Medicaid fraud cases. Government program fraud is costing the taxpayer billions of dollars every year. The Postal Service is one agency which has done something about it according to former Senator Frank E. Moss, whose Subcommittee conducted most of the major hearings involving fraud in government health care programs.

The Inspection Service of the U.S. Postal Service is one of the most efficient of government agencies. Its importance cannot be overstated since almost all frauds use the mails in one way or another. Giving the staggering growth in such frauds, it is obvious that the Service is undermanned.

No one is sure as to the exact size of the problem but there is agreement that the figure is in the billions. The Arthritis Foundation estimates that $1 billion a year is lost in phony arthritis cures alone. No one has any precise figures for losses in the business and investment frauds or of the amount lost to land fraud each year. It is clear that the accumulated total is massive.

The Committee sought to learn what authority the Inspection Service had to make their investigation. As noted, they enforce Title 18, United States Code, Section 1341, the mail fraud statute. The second statute—Section 3005 of Title 39 of the U.S. Code—is civil. This section relates to false representations made through the mails.

What is obvious from the above is that the Inspection Service can move against potential fraud either civilly or criminally. A criminal investigation must be conducted under the aegis of the United States Attorney's Office, who must be convinced that there is a case and that the case is of significant magnitude that prosecution will be undertaken. As Senator Moss testified before the Post Office Committee on May 20, 1982, it is an unhappy fact that only the largest of fraud schemes ever reach the level where they are important enough to be recognized as such by most U.S. Attorneys. However, it is only after convincing a U.S. Attorney's office that a case meet this criteria that the Service can proceed. In the words of Senator Moss:

> The Inspection Service is in a Catch 22 situation. They can only proceed if they convince a U.S. Attorney that they have a case and they can only establish that they have a case if they do an investigation which of course is not possible until they convince a U.S. Attorney's Office to let them do so.

Under the civil statute, Section 3005, the Service must build a strong enough case to convince an administrative law judge after formal hearings that there are false representations made with respect to one or more products sold through the mails. Senator Moss described this situation:

> In civil cases where false representations are made in advertising relating to matters sold through the mails, the Inspection Service has no way of obtaining access to the product described in an ad short of a test purchase. The Service needs the product in order to begin the investigation. Once the product is in hand the Service can have it evaluated againstt he claims that are made about it in the advertising in question. The service, its attorneys and experts can then come to some conclusion about the veracity of the ads and decide whether or not to pursue a false representation case. The unscrupulous promoters understand this, therefore, they wait three months and fill all orders at once as they are going out of business. This means that by the time the Inspection Service gets the product, there is no recourse.

Even if the Postal Service is successful in building a false representation case before an administrative law judge, all that happens is that a stop order is issued which bars the person who placed the ad from receiving mail in response to the ad. The mail addressed to this individual is returned to the sender. The con men who make mail fraud their profession simply change names or locations and continue the same schemes. In some cases they do not even do this, they flaunt the postal stop orders by forsaking the mails in favor of telephone 800 numbers which they use to market the identical products which have been enjoined often using the identical advertising.

As Chairman Pepper said in a March 1982 statement on the Floor of the House:

> It is amazing to me that the Postal Service has been able to accomplish as much as it has, given these limitations. The irony is compounded by the fact that the Chief Postal Inspector of the U.S. Postal Service is the prototype for the Inspectors General that we have now established in every other government department and yet we have failed to give the Inspection Service even a scintilla of the powers that we have given to all the other Inspectors General.
>
> In response to all of these problems, I introduced H.R. 3973. The bill does three things. First it would give the Chief Postal Inspector, who is the Inspector General of the Postal Service, subpoena authority with respect to the enforcement of Title 39 of the U.S. Code. Second, the bill gives the Inspection Service the authority to tender a postal money order at the address shown in a suspicious advertisement and immediately receive access to the product so that their evaluation by experts can begin at once. Third, the bill gives the Postal Service the right to approach an administrative law judge and after due process hearings, allow for the issuance of an order to the perpetrator not to engage in the described fraudulent scheme and punishing any violation or effort to evade such court order by Court imposed fines up to $10,000 for each violation.
>
> This is a very modest bill. It corrects an oversight in existing law. It does not cost the government any money. It will not result in any new regulations on industry. On the contrary, improved enforcement operation by the Inspection Service will pay dividends in the form of fines and penalties to the Federal treasury. Perhaps more important, the profiteers and charlatans who use the mails to defraud the poor, the uneducated, the weak and the elderly will be put on notice that they will face an Inspection Service not only with the heart to go after them but with the teeth and tools that it needs as well. I urge the immediate enactment of this legislation.

Shortly after the introduction of H.R. 3973, an identical bill, S. 1407 was introduced in the Senate by Senators David Pryor, Ted Stevens, John Heinz and Lawton Chiles. A quarter of the Senate joined them in this effort. Hearings were held. The bill was modified in Committee and passed the Senate on May 19, 1982.

Although there is no evidence that the Postal Service has abused its existing powers, major changes were made in S. 1407 to protect the rights of those who might come under investigation. The first of these changes relates to subpoena power.

Subpoena Power

Under the revised bill the Postal Service may issue civil investigative demands requesting information or documents from name individuals. It may not compel them to offer testimony under oath. The individual who receives a demand (a weaker form of subpoena) may choose to ignore the item. If he does so, *the burden is on the U.S. Postal Service to convince a U.S. District Court that the demand was specific, proper and germaine.* The person to whom the demand is addressed may be present in Court to contest the legality of the demand. The investigative demand must meet specific criteria laid out in the statute. The U.S. District Court decides the issue. This is certainly significant protection for anyone who receives a demand.

The above procedure contrasts with the subpoena authority written into H.R. 3973 which very closely mirrors the authority given to each of the Inspectors General. All of the inspectors general have civil

subpoena authority. The language creating the subpoena authority of the Inspector General of the Department of Health and Human Services (HHS) is typical. The language says only that the IG shall have authority "to require by subpoena the production of all information, documents, reports, answers, records, accounts, papers, and other evidence necessary in the performance of the functions assigned under this act, which subpoena in the case of contumacy or refusal to obey shall be enforceable by order of an appropriate U.S. District Court."

The HHS Inspector General simply signs a subpoena. The person to whom it is addressed must comply as directed or risk being held in contempt. The person to whom the subpoena is directed has the burden of showing in Court that a subpoena is invalid, improper or unfair. Only if the person sustains this burden in U.S. District Court will the subpoena be set aside by the Court.

Fines for Recidivists

The original bill, H.R. 3973, allowed Administrative law judges to issue fines up to $10,000 whenever a promoter sought to evade a stop order that they had issued. S. 1407, as it passed the Senate give this responsibility to the U.S. District Courts. The provision applies only when a promoter resorts to committing substantially the same scheme *in violation of an existing Court order.* The fact that U.S. District Courts instead of Administrative law judges would impose such fines, of course, serves to greater protect the interest of those accused of perpetrating false representation schemes.

H.R. 7044

On August 20, 1982, Post Office Committee Chairman William Ford and Subcommittee Chairman Mickey Leland joined Chairman Pepper in introducing a clean bill. H.R. 7044 preserves the basic intent of giving the postal service subpoena power but carefully spells out how those powers are to be employed and the limitations on those powers. Chairman Ford issued a statement in which he said:

> I am convinced that something must be done to stop the U.S. Mails from being used by opportunists to bilk many of our senior citizens out of their life savings. Our recent hearings examining this disturbing problem confirmed the findings made by Chairman Pepper in his Committee's exhaustive study.

H.R. 3973/H.R. 7044 is presently co-sponsored by some 310 Members of the House of Representatives. They have joined Chairman Pepper, ranking Republican Member of the Aging Committee, Matthew Rinaldo, and Chairman Ford in the belief that something must be done to increase the authority of the U.S. Postal Service to deal with the growing problem of mail frauds—including business and investment frauds—being perpetrated against all Americans but particularly the nation's 25 million elderly.

On September 28, the Post Office and Civil Service Committee reported out H.R. 7044.

V. SUMMARY AND CONCLUSIONS

This report examines the kinds and dimensions of business and investment frauds perpetrated against the elderly. Con men who promote these schemes prey on the fear of the elderly that they will not have enough money to support themselves in future years. In an effort to cope with the twin buzz saws of inflation and ever escalating medical costs, the elderly have sought security in some kind of job that they can do at home to supplement their social security. They have sometimes sought to invest their small retirement nest egg in order to have a larger amount available to them in their future years and, perhaps, even to allow them to leave something behind to their heirs.

Business and investment frauds are but one of the wide panoply of frauds being perpetrated against the elderly. This is not to suggest that fraud is limited to the elderly. On the contrary, it affects all Americans, young and old alike. However, it is clear that a disproportionate number of the victims of various frauds are senior citizens. Some 60 percent of the victims of medical quackery are senior citizens. Land fraud is almost exclusively targeted at the elderly and the elderly make up fully 30 percent of victims of business and investment fraud schemes.

There are a number or conclusions which result from this study which is based on questionnaires to all State Attorneys General and Department of Consumer Affairs as well as detailed analysis of thousands of cases in the offices of the Federal Trade Commission, the Commodities Futures Trading Commission and the Securities and Exchange Commission. Among these conclusions are the following:

1. *Fraud is a massive problem in our society today.*—Literally billions and billions of dollars are lost every year through an infinite number of con games and rackets. There are no precise numbers as to the extent of the loss but it is in the many billions of dollars. For example, the Arthritis Foundation estimates that $1 billion alone is lost to phony arthritis remedies. When cancer and other kinds of quackery are added, the total cost will be at least $3 billion a year. There are no figures for land fraud or pension fraud. The House Aging Committee estimated that $1 billion a year was lost by questionable or fraudulent insurance policies sold in supplementation of Medicare. There are no precise estimates with respect to business and investment fraud schemes but this is one of the largest and most lucrative areas of fraud. The Committee staff believes that such losses may exceed $5 billion a year.

2. *The problem is getting more serious.*—Questionnaires received by the House Select Committee on Aging are nearly unanimous that the incidence of fraud is increasing sharply. Law enforcement experts noted that as the economic situation deteriorates with high unemployment, the incidence of fraud increases.

3. *The elderly and poor are disproportionately represented in the victims of frauds.*—As noted, many ripoffs are exclusively targeted at the elderly. The elderly make up 11 percent of the population but 30 percent of the victims of crime—this figure relates to both white collar and violent crime.

4. *The elderly are especially vulnerable.*—Only a small number of them ever report being victimized because they are heartsick or just plain embarrassed. The elderly are vulnerable, first because they grew up in a more trusting era. Second, some of them have a little money put by. Third, they may not be accustomed to making large investments. Fourth, they have time on their hands and want to keep busy. Fifth, they desire to leave a little something to their children and grandchildren.

5. *The elderly are particularly vulnerable to business and investment schemes which prey on their fears that they will not have adequate income to support them in their old age.*—These fears are real. Some 25 percent of the nation's elderly have incomes placing them at or below the poverty line. In general, they can count on less than 50 percent of the income in retirement that they had when they were working. Medical costs continue to escalate at a rapid rate. Senior citizens are ill three times as often and hospitalized three times as long as the younger population with overall per capita medical costs almost four times what is paid by younger people. The natural fears of the elderly that they will not have enough money to support themselves have increased over the past year in view of legislative proposals to cut social security benefits.

6. *Business and investment frauds are particularly prevalent because of the large amount of money involved and because it is often impossible to tell a fraud from the great majority of legitimate business and investment apportunities.*

7. *The primary forms of business and investment frauds are:* (a) work-at-home schemes; (b) securities frauds; (c) franchise frauds; (d) distributorship frauds and (e) commodities frauds. There is an infinite variety of rackets within each of these major schemes.

8. *Like almost all frauds, business and investment schemes utilize the U.S. mails.*—A fraud game usually begins with an advertisement in a newspaper or magazine which contains fraudulent representations. The victim responds to the ad and does not receive what he or she expected. In some cases the victim receives nothing at all. In other cases, something quite different than expected. In other cases, the ad leads to the call of a salesman who completes the fraud. Even in other kinds of frauds such as Medicare and Medicaid fraud, where the taxpayer is the victim, phony Medicare claims are sent through the mails.

9. *The primary authority for identifying and prosecuting fraud rests with the states because under our Constitution these "police powers" are reserved for them.*—Few states have enacted Business Opportunity Statutes giving their State Department of Consumer Affairs or Attorney General's office wide powers to deal with phony business and investment claims. The State of Georgia is one state which has an effective program to root out such abuses.

10. *At the Federal level the Federal Bureau of Investigation has recently began to place more emphasis on white collar crimes.*—Neither

the Securities and Exchange Commission nor the Federal Trade Commission are as active as they once were.

11. The U.S. Postal Service and specifically its Inspection Service does an excellent job but the Postal Service has limited resources.—There are only 2,000 Postal Inspectors in the United States and they can spend an average of only 25 percent of their time dealing with mail fraud and false representation cases. There is a need to expand the number of postal inspectors so that the Service can be effective.

12. The Postal Service does not have the authority it needs to do the job.—Congress has vested in the Postal Service the responsibility for identifying and prosecuting mail fraud and false representations at the Federal level and yet the Congress has not given the Service even that rudimentary investigative tool, the power of subpoena.

13. Because of the absence of subpoena power, the U.S. Postal Services is in a Catch 22 situation.—They can choose to proceed either criminally or civilly, but the Catch 22 applies in both situations. They may proceed in investigating a criminal case only after they have convinced a United States Attorney that they have significant evidence to build a successful Federal prosecution and they cannot build such a case without first doing an investigation which, of course, must be authorized by the U.S. Attorney. On the civil side, the Postal Service must build a case to convince an administrative law judge that a false representation has been made in a particular advertisement. The Service cannot make such a case without having access to the product and having it evaluated against the claims made about it. The Service has no means of obtaining the product short of a test purchase. The con men know this and fill all their orders 60 days after an ad has been run as they are closing down their office. By the time the Postal Service receives the product, there is no recourse.

14. Penalties imposed in false representation cases are too light and recidivism is a common problem.—A review of U.S. Postal Service cases shows that many of the same individuals are involved in one fraud case after another. The problem seems to be that even if the Service is successful in convincing an Administrative Law Judge that fraud has been committed, all that happens is the issuance of an administrative mail stop order. The stop order serves to prohibit mail (in response to a particular ad) from being delivered to the person found to have been making false representations in his advertisements. Con men and mail fraud artists simply change their corporate name and address and begin the same schemes all over again. At times they do not even do that. It is not uncommon for con men to continue the same scheme using the same name and address and the same product advertising by means of telephone 800 numbers instead of through the mails. Clearly, some action is necessary to deal with the recidivists and those who now flaunt judicial orders with impunity. One solution may be to impose a $10,000 judicially imposed fine for each violation of an existing Court order, particularly for continuing a judicially barred scheme by means of a different instrumentality of interstate commerce (the telephone instead of the mails).

All of these facts taken together (and butressed by the hundreds of cases in this report) make it clear that something must be done to deal with the growing scandal of business and investment frauds. Suggestions for reform follow.

VI. SUGGESTIONS FOR REFORM

As noted in Section II of this report, it is the consensus of experts in this field that nothing short of a full-scale concerted Federal-State effort will serve to reduce the serious incidence of business and investment fraud schemes being perpetrated on the American public and particularly upon the elderly. Reform must take several forms. First there must be an effort to educate the public on the kinds of schemes so that they will be in a better position to protect themselves. Second, there needs to be better communication between State and Federal law enforcement agencies. Third, States need to enact new tough laws giving their State Attorneys General and Departments of Consumer Affairs the tools they need to deal with such frauds. Fourth, there needs to be more prosecutions which also means more people are needed to fight fraud in the relevant government departments. This study leads to two specific suggestions:

1. The States which bear the primary responsibility for identifying and prosecuting business and investment (as well as other kinds of) frauds should look very carefully at the Georgia Business Opportunity Statute. It may serve as a model which they may wish to emulate.
2. Congress should enact H.R. 3973/H.R. 7044 introduced by Chairman Claude Pepper along with ranking Republican Member Matthew Rinaldo in March 1982. The bill has been cosponsored by more than 310 members of the House including some 90 percent of the members of the House Aging Committee.

H.R. 3973 has passed the Senate on May 19, 1982 in the form of S. 1407 introduced by Senators David Pryor, Ted Stevens, John Heinz and Lawton Chiles along with some 21 additional members of the Senate.

H.R. 3973 has been the subject of hearings by the House Post Office Committee whose Chairman, the Honorable William D. Ford has helped to further shape the bill and along with Subcommittee Chairman Mickey Leland and Chairman Pepper has introduced a revised version of the legislation, H.R. 7044.

H.R. 7044 continues the basic principles of H.R. 3973. It would give the U.S. Postal Service the authority to issue investigative demands in carefully controlled conditions so as to protect the rights of individuals. The bill would authorize the Inspection Service to have immediate access to a product either through the use of an investigative demand or through a test purchase. This will solve the "Catch 22" problem spelled out in Sections IV and V of this report. In order to deal with the problem of recidivists, the bill would authorize up to $10,000 per violation in penalties which could be assessed by a U.S. District Court Judge if and when he/she found that in violation of an existing Court order, a promoter was continuing essentially the same fraudulent scheme previously enjoined.

H.R. 3973/H.R. 7044 has wide bi-partisan support in the Congress and was reported by the House Post Office Committee with an overwhelming vote of support. It is supported by the Administration both through the Office of Management and Budget and through the U.S. Postal Service. The Congressional Budget Office has found that it will not cost any tax money to implement.

This is a very modest step. It will not result in any new government regulations. On the contrary, it will improve the enforcement operation of the Inspection Service of the Post Office Department and will pay dividends to the Federal Treasury in the form of fines and penalties to say nothing of the millions of dollars in fraud that might be saved.

Perhaps more important, the profiteers and charlatans who use the mails to defraud the poor, the uneducated, the weak and the elderly will be put on notice that they will face an Inspection Service not only with the heart to go after them but with the teeth and other tools they need as well.

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