

Approved: 3/14/97
Date

MINUTES OF THE HOUSE COMMITTEE ON BUSINESS, COMMERCE & LABOR.

The meeting was called to order by Chairman Al Lane at 9:05 a.m. on February 20, 1997 in Room 526-S of the Capitol.

All members were present except: Rep. David Adkins - excused
Rep. Broderick Henderson - excused

Committee staff present: Jerry Donaldson, Legislative Research Department
Bob Nugent, Revisor of Statutes
Bev Adams, Committee Secretary

Conferees appearing before the committee: Alan Bibler, Attorney, CheckRite of E. KS
Bud Grant, KCCI
District Judge Thomas Tuggle
Rep. Doug Mays
David Brant, Securities Commissioner
David Debenham, Deputy Attorney General
Roger Walter, Securities Commission
Bill Freeman, Mayor of Leroy, KS

Others attending: See attached list

Continued hearing on: HB 2205 - Civil remedy for worthless checks; defining intent to defraud and reasonable attorney fees.

Alan Bibler, Attorney at Law for CheckRite of Eastern Kansas, appeared as a proponent of the bill. Ninety percent of his practice is taken up with worthless check cases. **House Bill 2205** removes the "adequately compensated" provision in its entirety from the statute and defines what constitutes a "reasonable attorney fee" for these cases. (see Attachment 1) He concluded by answering questions from the committee.

Many of the conferees who attended the committee meeting on February 19 were unable to attend the meeting today.

Bud Grant, appeared on behalf of the Kansas Retail Council, a division of the Kansas Chamber of Commerce and Industry. He asked the committee to pass out the bill favorably to continue the Legislature's efforts to address the losses associated with worthless checks. (see Attachment 2)

District Judge Thomas Tuggle, Twelfth Judicial District of Kansas, appeared as an opponent of the bill. He feels that attorney's fees should be left to the discretion of the Court.

Action on: HB 2011 - Workers compensation pools, rating organizations.

Rep. Geringer made a motion to pass out the bill favorably. It was seconded by Rep. Beggs. The motion passed.

Action on: HB 2154 - Real estate appraisers, real estate-related transactions.

Rep. Grant made a motion to table the bill. It was seconded by Rep. Mason. The motion carried and the bill was tabled.

Action on: HB 2205 - Civil remedy for worthless checks; defining intent to defraud and reasonable attorney fees.

It was decided that Rep. Pauls would bring a balloon amendment for the bill to tomorrow's meeting.

Hearing on: **HB 2230 - Prohibiting pyramid promotional schemes.**

Rep. Doug Mays appeared before the committee to introduce the bill. When he was Securities Commissioner, he had some experience with pyramid schemes. When these schemes collapse they hurt a lot of people. The further the schemes go the more people are hurt and the more money is lost.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON BUSINESS, COMMERCE & LABOR, Room 526-S
Statehouse, at 9:05 a.m. on February 20, 1997.

David Brant, Kansas Securities Commissioner, appeared as a proponent of the bill. There is no statute that makes promotion of pyramid investment schemes a crime in Kansas. He estimates that in the last four months that various pyramid schemes have redistributed over \$3.5 million due to the participation of at least 1,000 people who then enabled some 200 pyramid CEOs to retire or cash out. About \$2.5 million was repaid due to the efforts of different agencies. Making the promotion of pyramid investment schemes a crime in Kansas would tell our citizens that this activity is illegal and act as a deterrent to the promoters. Thirty-five other states now have a law against pyramid investment schemes. He requested that the enactment clause be changed to publication in the Kansas Register. (see Attachment 3)

Deputy Attorney General David Debenham talked from the audience to explain the penalty for the promotion of pyramid investment schemes. A conviction of this crime would be a severity level 9 and carry a sentence of presumptive probation unless the person has had two prior person felonies and the sentence would be more severe.

Roger Walter, General Counsel for the Securities Commission, answered a question from the committee about the penalty for the willful violation of the Securities Act.

Bill Freeman, Mayor of Leroy, Kansas, appeared as a citizen of a town that was hit hard with one of these schemes. He stated that the greed is unbelievable with persons who are participants in these schemes. He told the story of how the seniors in high school wanted to take their senior fund and invest it to increase the money for their senior trip. The scheme had a very negative impact on his community. (see Attachment 4)

The hearing on **HB 2230** will be continued tomorrow.

Chairman Lane adjourned the meeting at approximately 10:00 a.m.

The next meeting is scheduled for February 21, 1997.

HOUSE BUSINESS, COMMERCE & LABOR COMMITTEE
GUEST LIST

DATE: February 20, 1997

NAME	REPRESENTING
Ken Smith	Ks Bar Assoc
Austin Nothem	Ks Bar Assoc
T.C. Anderson	KSEPA
Rocky Walter	Ks Sec. Comm.
DAVID BRANT	SECURITIES COMMISSIONER
Tom Trigg	Ks Dist. Judges' Assoc
BUD GRANT	KCC
David Debenhan	Attorney General
JASON PROUDERMAN	KGC
Jason Oldham	OSA
Rick Fleming	Securities Commissioner
STEVE HULSEPP	SECURITIES Comm.
David Shufelt	Dept Human Resources - Div Work Comp
Clinton Ehlert	Accounts + Reports
Russ Hammer	City of LeRoy Ks
Jeff Sornich	HCBA
Matt Geddard	HCBA
JOHN C. BOTTENBERG	NCCF
Andrew Sabolic	NCCI

Testimony before the House Committee on Business, Commerce & Labor,
Wednesday, February 19, 1997, By Alan Bibler, Attorney at Law for
CheckRite of Eastern Kansas

About 6-7 years ago when I first started handling worthless check cases for CheckRite, I did some basic research to determine what other attorneys in this area charged for this type of case. I found that the going rate was \$250.00/case. My partner and I discussed this and thought this was too high. We estimated that these cases would require an average of about 3 hours each. We were charging our preferred clients an hourly rate of \$63.00/hour at that time, so we rounded off and decided to charge \$180.00/case.

Two years and three months later, when our partnership broke up and each of us started our own law firms as sole practitioners, I did an analysis of my fee structure, particularly as it pertained to these worthless check cases, as I kept CheckRite as a client after the breakup of the partnership. I determined that I was averaging 60 hours/week and spending approximately 50% of that time on these cases. I further determined that after covering the basic expenses of operating an office, etc., during that entire 27 month period, these cases had generated less than \$5,000, total, with which I could pay myself. That comes out to \$1.46/hour.

It didn't take me long to recognize that I had to do a number of things, one of which was to increase my fees for these cases. By that time, the other attorneys were charging \$270.00/case, so I increased my fee to \$250.00, October, 1992. Since then, the demands of these cases has increased to the point where I now spend over 90% of my time on these cases. I have continued to analyze the return from this service. I have not found time to work up the figures for 1996, but I can tell you that, assuming only a 50/hour week, during 1994 and 1995, my firm grossed \$21.59/hour and \$28.10/hour, respectively from these cases. Understand that these figures are gross hourly revenue, from which all of the costs of operating the law firm must be paid. It does not require the intelligence of a rocket scientist to recognize that I am not getting rich providing this service. My salary from the law practice during those two years ranged from \$2,000/month during 1994 to \$2,500/month during 1995 and on throughout 1996.

I'm not telling you this to elicit sympathy; I have chosen this work, I like what I'm doing and I believe I provide a needed service. I'm providing you with these facts to counter the argument that I hear from a small group of people who don't know what they are talking about. This group includes a few district court judges, some of whom have stated that they don't approve of K.S.A. 60-2610, the "civil worthless check law." They make

1

*Business, Commerce
& Labor Committee
2/20/97
Attachment 1*

statements to the effect that the attorneys and collection agencies who use this law to recover on worthless checks for their clients are all "getting rich" doing this. If I don't convey anything else to you today, I hope that I make it clear that this attorney certainly isn't getting rich as a result of providing this service. There may be some others out there who are, but I don't think so.

One of the facts that so many of those who think some one is getting rich at this business fail to take into consideration is the extra ordinarily high costs of providing this service. These costs range from "hard costs" such as computerized record keeping, word process and filing equipment to "soft" costs which include the fact that this service requires a great deal of time. Lawyers who operate firms providing general legal services, i.e., family law practice, wills, etc., have no idea of the overhead that a collection attorney must deal with. I suspect that some of the larger collection attorneys spend more in postage- in any given month than the general practitioner pays for his or her malpractice insurance for a year. And, speaking of malpractice insurance, the premium for a collection attorney is much larger than that of a general law practitioner. The very nature of dealing with collections and debtors means that over and above the type of overhead that the general practitioner has, the collection attorney has to run what is for all practical effect a private investigation operation.

It is not at all unusual for a single worthless check case to involve the need to "skip trace" the maker 2-3 times just to get to the judgment stage. Several more skip traces may be required during the post-judgment or collection stage. Skip tracing is a very resource intensive process, requiring a lot of personnel time and a significant amount of equipment and the expenditure of funds. And, the fact is that a significant percentage of the resources that go into the skip tracing effort will prove non-productive because of any one of several reasons, i.e., the debtor effectively disappears, or the debtor proves to be, for all practical purposes, judgment-proof, or the debtor, when finally cornered, simply files bankruptcy. All of this is a normal part of the overhead that a collection attorney must absorb but which a general law practitioner never sees.

Also, the general law practitioner doesn't face the maze of laws that are in place for the primary purpose of protecting the rights of the debtor. Please understand, I am not criticizing these laws or their purpose; I fully understand that there have been and probably still are a lot of individuals and/or firms who would not hesitate to take unfair advantage of debtors if given the opportunity. What I hope you understand, however, is that these

laws, as necessary as they may be, nonetheless pose a significant - and costly, obstacle to the collection attorney or agency.

One of the major obstacles is the passage of time. Time is always of benefit to the debtor. Every day that passes without the collection of a given debt decreases proportionally the likelihood that that debt will be collected. Debtors move, change jobs, change names, etc., some purposely, many just in the normal course of events. With the passage of time, the debtor that initially meant to repay a given debt, often undergoes a hardening of the attitude. I often get a response from the maker of a worthless check to the effect of, "That check is over two (or three, or whatever) years old." Basically, what they are saying is, "I shouldn't have to be bothered with that now," or, "You should have caught me a long time ago, since you didn't, I ought to get away with it." This attitude completely overlooks the fact that this person has probably been dodging not only this creditor but several others as well for all of that time.

What a lot of non-involved observers of this collection process fail to see is that we have to comply with the federal Fair Debt Collection Practices Act (FDCPA) throughout this process. An example of what that means here is the fact that we have to track down a good address, prepare and deliver to the alleged debtor or worthless check maker an FDCPA notice, in writing, before we can do anything else. Then, we have to set back and wait 35 days before we can initiate the 14-day notice letter required by K.S.A. 60-2610. By that time, a significant percentage of these people will have moved and/or changed jobs once again.

It is not at all unusual to finally find some debtor for whom your client has had a debt due for 2-3 years only to find that locating him or her and forcing them into court simply provides the "straw that breaks the camel's back," and drives the debtor into bankruptcy. Many dollars in time, salaries, research fees, etc., are then lost, with little or no hope of recovery. The collection attorney simply has to absorb that as a legitimate part of overhead.

Another effect of the FDCPA is to increase overhead costs for the attorney with a significant collection practice. Let me assure you that no matter how conscientious the attorney may be, it is virtually impossible to operate a large collection practice without at least some minor violations of that act. And, I can personally guarantee you that there are attorneys, primarily from the East coast area, roaming the country, scouring courthouses, searching for opportunities to bring lawsuits against collection agencies and/or their attorneys. I doubt seriously if there is a single

collection attorney who has been in practice for any significant length of time and who has a sizeable practice that hasn't paid one or more out-of-court settlements to these vultures. Just one more example of overhead that the collection attorney has to cover but the general practitioner never is even aware of.

Judges and other attorneys who make statements such as, "It only took you five minutes to prepare that petition and you had to appear at the docket anyway for your other cases, therefore, a fee of \$50.00 should be plenty for this case," fail to take into consideration that the collection attorney will almost certainly have spent a minimum of an hour doing nothing more than keeping on top of the file in that case to ascertain that all of the steps necessary to comply with all of the applicable laws have been met. If there was some skip tracing involved as well, the collection attorney may very well have \$100.00 in time and other costs before ever getting to the stage of filing the petition. Then, as is often the case, the debtor moves again, leaves his or her job, etc., between the time the case was finally filed and the docket date, and it becomes necessary to undertake another skip trace just to get service of process on the defendant.

Two more thoughts that I would like you to consider. By the time the collection attorney has gone through all of the steps necessary to file a petition, you can rest assured that, with perhaps a very few exceptions, the defendant is not just some innocent little old lady on social security who simply made a math mistake on her check register and bounced a single check. He or she will not be some innocent college student who wrote a check expecting to receive some money from mom or dad that he or she could deposit in time to cover the check. By the time the process gets to the point where a petition is filed, the maker of that worthless check will have been given a minimum of 3-4 notices and had a minimum of 50-60 days in which to make the check good. By this point in the process, we are almost certainly dealing with someone who either fully intended to defraud the holder when they passed the worthless check or, at the very least, has long since made up his or her mind to get away with it entirely or for as long as possible. And, the odds are good that this person will have passed other worthless checks as well. This will not be someone for whom we should all have great pity. This is someone who has unjustly enriched him- or herself at the expense of another and, unless he or she is made to pay, you and I will have to pay higher prices for the goods or services that we buy to make up for what this person wrongfully took.

Also, for those who lament the fact that a \$20.00 worthless check might result in a \$400.00+ judgment, consider the alternative. That person could be prosecuted under the criminal statute and wind

up with a criminal record. This, of course, is the way things were done prior to the adoption of this civil worthless check prosecution law in 1986. The problems then were, and will be again if those who want to undermine this law until it is useless have their way, that the criminal prosecutors didn't have time to handle these cases, many of them thought it was beneath them to be acting as collection agents for businesses, the costs of public prosecutors and court time was too high to justify handling these cases and, in general, these kind of cases simply didn't get handled and the businesses had to absorb or pass on to their other customers the costs of their worthless checks.

And, these costs are significant. While I don't have figures for Kansas alone, the costs nationwide are estimated to be \$16-18 Billion dollars and are projected to increase at the rate of 2.5% per year through the year 2020.

I could go on much longer, however, I know everyone here has a lot of important things to do and too little time to do it. I hope that I have impressed upon you at least some idea of the expense involved in the business of legal debt collection practice.

Frankly, I believe that at least some of the thankfully small number of judges who routinely undermine this civil worthless check law by waiving or drastically reducing the attorney fees in these cases, do not even care about what it may cost to prosecute these cases. I honestly believe that some of these judges are simply so biased in favor of debtors and/or against businesses that they are merely using this mechanism of waiving and/or reducing attorney fees as a means of thwarting this law.

You are being requested to shore up the provisions in this law that require the bad actor, the worthless check maker, the one who is responsible for every cost that is incurred as a result of forcing the worthless check holder to undertake a lawsuit in order to recover what is due to them, to bear the total cost of that lawsuit.

For almost three years, all of the judges in one judicial district had a rubber stamp which they used to stamp above their signature on the journal entries of judgment: "The Court finds the damages and other amounts awarded are sufficient to adequately compensate and attorney fees are waived." A rubber stamp! This was in cases where the defendant had never appeared and had never raised any objections, where there was absolutely no evidence in the record to support this finding. This routine practice cost my client tens of thousands of dollars and it also cost me many thousands as well. These judges were doing this because they believed that I, as the

attorney in these cases, was being paid some or all of the damages awarded.

Let me address that briefly. First, even if I had received all of the damages in those cases, since about 85% of these cases involve worthless checks of less than \$33.33, the damages would only be \$100.00. I hope I have demonstrated earlier that these cases can not be handled for \$100.00. Secondly, I do not get any part of the damages in these cases as part of my fee. Maybe some attorneys do; I do not. What these judges were doing was forcing me to work free; neither my wife nor my banker appreciate that.

During the last session of the legislature, you were requested to remove the provisions in the civil worthless check law that gave the court discretion to waive the attorney fee when it was felt that the award of the damages was sufficient to adequately compensate the holder. Elimination of that provision was passed in the Judicial Committee but later removed on the floor. Still later, when the two bills passed by the House and the Senate were in conference committee, a compromise was reached requiring the court to "make a finding of fact as to the specific reasons that the amounts awarded are sufficient to adequately compensate the holder of the check." The expectation was that the courts, being unable to do that since there were no such specific reasons, would discontinue this practice of using a rubber stamp to waive attorney fees.

Well, it worked! They did quit using the rubber stamp. However, they simply changed tactics. Beginning with each new journal entry of judgment that I submitted after the effective date of the revised law, these judges determined that the attorney fees requested are unreasonable and either waived them entirely or drastically reduced them to amounts like \$50.00, \$70.00, even \$40.00, with an occasional \$100.00 or \$150.00. Again, this is being done without any hearing, without any questioning or even the appearance by the defendants and without any evidence in the record to support such a finding.

This is why you are being asked this session to remove that "adequately compensated" provision in its entirety. It is also why you are being asked to define what constitutes a "reasonable attorney fee" in these cases. It is clear that at least some courts will utilize whatever loophole left available to them to undermine the legislative intent of this law, that being that if the worthless check maker forces the worthless check holder to resort to the legal system to recover for the worthless check, the worthless check maker will bear the full costs of that process. Anything less renders the law virtually useless.

Please understand, as an attorney, I am also a businessman. I must be able to charge and receive a fee for my services, a fee that allows me to cover my costs of operating an office and provides to me a return on my investment. Anything less defines an "unreasonable fee."

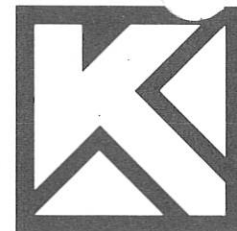
Finally, you are being asked to define the term "intent to defraud." The original bill adopting what is now K.S.A. 60-2610 and 2611, also included what is now K.S.A. 21-3707, the criminal worthless check law. There, "intent to defraud" is defined as the failure of the worthless check maker to pay to the holder an amount equal to the face value of the worthless check plus a \$10.00 service charge within seven days after being given notice that the worthless check was dishonored. It goes on to define notice as including oral or written notice. In other words, the requirements of proof in the criminal worthless check law are less burdensome than that in the civil worthless check law where the worthless check maker is given fourteen days notice and it must be written and sent via registered mail. You are not being asked to weaken any of that, but simply to provide a definition of what constitutes "intent to defraud."

Thank you for your time and for your consideration of this matter. Your help is needed if this civil worthless check law is to remain effective throughout the state. Without these changes, it is clear that some district courts will purposely or otherwise undermine the law to the point where attorneys will be prevented from providing the service so sorely needed by the business people throughout Kansas.

If there are any questions, now or later, I will welcome the opportunity to attempt to answer them.

LEGISLATIVE TESTIMONY

Kansas Chamber of Commerce and Industry



835 SW Topeka Blvd. Topeka, Kansas 66612-1671 (913) 357-6321 FAX (913) 357-4732

HB 2205

February 19, 1997

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

House Committee on Business, Commerce & Labor

by

Bud Grant
Vice President and General Manager

Mr. Chairman and members of the Committee:

My name is Bud Grant and I am here on behalf of the Kansas Retail Council, a division of the Kansas Chamber of Commerce and Industry. I appreciate the opportunity to appear to express support for HB 2205.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 46% of KCCI's members having less than 25 employees, and 77% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

Through the years the Kansas Legislature has been consistent in its support of addressing the problem of worthless checks. The problem has reached epidemic proportions. The latest information which I have available from the Fraud Information

Business, Commerce & Labor Comm.
2/30/97
Attachment 2

Bureau is that over 425 million bad checks are returned in the United States each year and 62% of these are not made good on deposit. According to the American Bankers Association, worthless checks amount to about 1% of all checks written.

To retailers, customers who write bad checks are thieves with paper guns. But to police and prosecutors, chasing check bouncers is rarely a high priority. That is why this legislature enacted the civil recovery statutes, and why all the costs of collection, including attorney fees, should be fully recoverable. Anything less discourages pursuing the writer of the bad check. This results in higher prices for the rest of us and less money to the state as bad debt losses reduce profitability and taxes.

I urge the committee to continue its efforts to combat the losses associated with worthless checks and to recommend HB 2205 favorable for passage.



KANSAS

Bill Graves
Governor

OFFICE OF THE SECURITIES COMMISSIONER

David R. Brant
Securities Commissioner

TESTIMONY IN SUPPORT OF HOUSE BILL No. 2230
Prohibiting Pyramid Promotional Schemes
Business, Commerce and Labor Committee Kansas House

DAVID BRANT
Kansas Securities Commissioner
February 20, 1997

Mr. Chairman and members of the committee, thank you for this opportunity to testify in support of House Bill No. 2230 which proposes to make a crime of the promotion of pyramid investment schemes.

What is a Pyramid Scheme? Section 1 of the bill provides the proposed statutory definition. The pyramid in its purest form is much like a high-stakes version of a chain letter. For the past four months, a \$2,000 cash pyramid scheme has been promoted, under the names of "People Helping People," "Friends Helping Friends," "The Support Network," and "The Board Game," in a total of 27 counties with the most activity in the Wichita area and Anderson, Barton, Crawford, Coffey, Pawnee, and Reno counties. (See the back of **Exhibit A** for a list of the counties currently known.)

A copy of the "rules" of the programs and the pyramid diagram (referred to as a "board") are attached as **Exhibit B**. Potential investors are told to bring \$2,000 in the form of \$100 bills to a secret meeting (referred to as a "social" or a "party"). Participants are kept on a first name basis and are told that the program is legal, not subject to taxation, and that the cash is a "gift" to the pyramid leader (referred to as the "CEO"). The pyramid typically consists of four levels with the CEO, two presidents, four vice-presidents, and eight investors at the base. At a successful meeting, the eight new investors pay a total of \$16,000 to the CEO who then "retires." The pyramid then divides into two groups and each participant advances to the next higher level. New investors are then recruited to fill the bottom levels of the two new pyramids and the process is repeated.

The District Attorney in Sedgwick County, Nola Foulston, notified our office in late October of a number of calls in the Wichita area concerning this pyramid scheme. Our agency cooperated with the District Attorney in alerting the news media to warn citizens not to participate. Nonetheless, the pyramid activity continued to spread to other communities and counties. Also copied on **Exhibit A** is a sample newspaper clipping of the statewide alert issued by our agency in November.

Many pyramids attempt to establish their legitimacy by purporting to sell a product and are not as blatant as the cash pyramid just described. There are legitimate multi-level marketing programs which promote the sale of goods or services. The distinguishing test is whether the program

*Business, Commerce
& Labor Committee*
2/20/97
Att. 3

concentrates on the quick profits to be earned primarily from the recruitment of other people to sell the program as opposed to the sale of legitimate products at an attractive price. Our concern today is with the promotion of pyramid schemes.

Pyramid Schemes are Illegal. A pyramid scheme constitutes an "investment contract" which is defined as a security under the Kansas Securities Act (K.S.A. 17-1252j). Securities must be registered with our agency or be exempt to be offered to Kansas investors. The current pyramid schemes are not registered securities, are offered by unregistered persons, and are being promoted in a fraudulent manner.

After an extensive investigation, our agency is empowered to bring criminal charges against the promoters in addition to a civil suit to disgorge the profits. The Kansas Supreme Court affirmed in a 1991 opinion that the "airplane pyramid" scheme was a security and that its promotion constituted an illegal conspiracy to sell an unregistered security. State ex rel. Mays v. Ridenhour, 248 Kan. 919, 811 P.2d 1220 (1991). However, the prosecution of pyramid schemes under the securities approach is cumbersome and time-consuming... and the biggest problem is that its illegality as an investment contract is not widely known or understood.

The word "pyramid" does not appear in the context of a crime, if at all, in the Kansas statutes. Some players have even consulted attorneys who were unsuccessful in their attempts to determine its legality. Participants are told by the promoters (usually a co-worker, friend, or family member) that the programs are legal. Some promoters are influential and community leaders to be trusted. Thus, even though the program "seems too good to be true...", many Kansans proceed to play based on these ill-informed, naive assurances that the program is legal.

There are at least 35 other states that have specific statutes similar to House Bill No. 2230 including the states of Missouri, Oklahoma, and Colorado. The time is long overdue for Kansas to adopt such a law.

Pyramid Schemes are a Public Nuisance. A pyramid scheme is doomed to fail and constitutes a zero sum gain... for every winner there are multiple losers. The schemes involve no gainful employment of labor, capital, or other legitimate economic enterprise. Pyramids are simply a method of transferring money from an increasing number of new participants to a smaller number of earlier participants. As the number of new investors required to support the program grows exponentially, the market for such investors ultimately collapses. There is no better example of the ultimate consequences of a pyramid than the tiny country of Albania. **Exhibit C** contains a sample of the daily news stories that have reported riots and widespread social unrest due to the devastating economic impact of the fraudulent pyramid investment schemes which have now finally collapsed.

Here in Kansas, we estimate that the various pyramid schemes have redistributed over \$3.5 million due to the participation of at least 1,000 people who then enabled some 200 pyramid CEOs to retire or cash out. We estimate that \$2.5 million has been repaid due to our warnings and the actions of our agency, the District Attorney, county attorneys, and local law enforcement. In Coffey County alone, we know that \$480,000 was generated by 112 participants with 30 individuals cashing out. Because of our efforts, we have received proof that \$448,000 has been returned to the participants to date.

The impact of a pyramid on a Kansas community is best told by those who have witnessed the results. **Exhibit C** also contains copies of a Letter to the Editor signed by two Burlington ministers and an editorial from *The Anderson County Review* in Garnett. In a minute, you will hear testimony from Bill Freeman, the Mayor of LeRoy and a local banker.

The President of Albania recently conceded that "maybe a lack of legislation" allowed the pyramid schemes to proliferate in his country. We ask that you support House Bill No. 2230. The proposed specific statute should act as a deterrent since it would clarify the illegality of pyramid schemes in Kansas. The statute should be effective in putting promoters on notice and will hopefully prevent Kansans from being enticed to invest in future pyramid schemes. **Exhibit D** is a letter of support for the bill from the Office of the District Attorney in Sedgwick County.

In the meantime, we will be diligent and continue our success in shutting down these schemes and in seeking the return of participants' money. The Office of the Securities Commissioner strives to fulfill our mission **to protect and inform Kansas investors.**

Lastly, we would respectfully request that the committee amend the bill to make the act effective upon publication in the Kansas Register. Thank you for your consideration.

3-4

Fred Johnson,
Topeka Editor..... 295-1181
Steve Swartz,
State Editor..... 295-1194
E-mail state@cjnetworks.com

Topeka/Kansas

Saturday, November 23, 1996 Page 9-A

THE CAPITAL JOURNAL

Official warns citizens to avoid pyramid scheme

Securities Commissioner David Brant said more than 1,000 Kansans have been cheated in the illegal investment scam.

By TIM HRENCHIR
The Capital Journal

The state's securities commissioner warned Kansans on Friday not to take part in an illegal pyramid scheme authorities think has suckered in more than 1,000 "investors."

Securities Commissioner David R. Brant said the scheme started about a month ago in the Wichita area and has spread to Anderson, Coffey, Cowley, Reno, Sumner and Saline counties.

He said there are a number of active variations on the scheme, which violates Kansas securities

laws and preys on people's desire to get something for nothing.

In the most popular variation, people are asked to invest \$2,000 in \$100 bills in hopes of converting that into \$16,000. As a result, Brant said, two different small-town banks in Coffey County were cleaned out of \$100 bills withdrawn by clients authorities think were taking part in the pyramid.

Brant added that two variations on the scheme had popped up in Wichita-area high schools.

Involvement in such a pyramid could leave participants open to civil lawsuits and criminal charges for violation of state securities laws,

Brant said.

No arrests have been made or charges filed in connection with the scheme, but, Brant said, Sedgwick County District Attorney Nola Foulston plans to begin inquisition hearings to question participants.

"We can have little sympathy for those investors who are driven by greed and attempt to turn a fast buck at the expense of a family member, friend or co-worker who is enticed to put up their cash as part of the scheme," Foulston said.

Brant said the pyramid works like this:

Potential investors are asked to

bring their money — usually \$2,000 but sometimes smaller amounts as low as \$25 or amounts as large as \$10,000 — to a site where they will learn where to go to attend a secret meeting.

At that meeting, participants are kept on a first-name basis only. They are told the program is legal and non-taxable, and that their cash is a "gift" to the person at the top of the pyramid, known as the "CEO."

The pyramid typically consists of four levels, with the CEO on top, two "presidents" on the second, four "vice presidents" on the third and eight "investors" at the base.

When eight people at the base

have made investments, the CEO takes that money and steps aside. One of the presidents moves up to the CEO slot, while others move up in the pyramid hierarchy.

Investors are told that as long as new investors continue to be found, they will eventually find themselves in the CEO position and receive eight times their investment.

"But all such schemes are doomed to fail," said Brant. "Somebody's going to get hurt, if they haven't already."

Authorities think at least one person from outside Kansas helped get the scheme started in Sedgwick

County.

Brant said involvement in the scheme has slowed down in that county, where authorities have identified some of the principal people involved, but is spreading to other parts of Kansas.

The scheme is promoted under various names, including "People Helping People," "Friends Helping Friends," "The Board Game" and "The Support Network," Brant said.

He encouraged anyone with information about pyramid investment schemes to call the Investment Hotline in the Securities Commissioner's office at 1-800-232-9580.

EXHIBIT A

3-5

**COUNTIES AFFECTED BY
THE PEOPLE HELPING PEOPLE PYRAMID SCHEME**

Allen
Anderson
Barton
Bourbon
Butler
Coffey
Cowley
Crawford
Douglas

Finney
Franklin
Harvey
Johnson
Kingman
Labette
Lyon
Miami
Montgomery

Neosho
Osage
Pawnee
Reno
Sedgwick
Shawnee
Sumner
Wilson
Woodson

Here's how the pyramid is presented:

Editors Note: This newspaper acquired what is reported to be a set of the documents that were used to entice people into "giving" money into the program that has been ruled to be a pyramid scheme. It is expected that more information will be available by the Monday publication deadline. Again, what follows is what was reportedly given to prospective members of these schemes.

THE SUPPORT NETWORK

The support system originated in Asia. Family members, as well as friends, basically formed their own financial support organization rather than borrowing from a bank or lender. They pooled their own moneys to help someone come to the US and start a business. The recipient did well and returned the gift by helping another ... and so on. Our Support Network is a social club dedicated to pooling resources, talents and finances together for the benefit and advancement of all, based on trust and integrity. The Support Network is not about getting rich. It is to provide networking opportunities and support as well as financial support to those you care about. It is a system whereby members each perform their duties carefully and are given cash gifts for their loyalty and efforts to perform their duties well.

The Support Network consists of 15 active members made up of friends or family who wish to help others by pooling a cash gift. This gift is not taxable by the IRS. By the IRS regulation, you are allowed to give or receive up to \$10,000 per person, per year without taxation, you are not required to declare money given or received as gift on your tax return. This gift has already had taxes paid on it and cannot be taxed again.

Why would you want to join? It's fun! We share talents with others from different walks of life and we explore the unique opportunities these people offer. Plus the energy surrounding our meetings is sometimes awesome!

How does it work? We have four positions in the club. New Members (8), Vice Presidents (4), Presidents (2) and the Chairperson or CEO. Guests are invited to our socials and are extended the same opportunity as the officers were offered previously. As soon as there are eight New Members on a "Board", each of them gifts \$2,000 to the Chairperson. The Chairperson's meeting is offering Board Members an array of opportunities from which to choose; i.e., business consultation, brokerages, travel, trade discounts, computer consultation, healing alternatives, handyman exposure, and financial consultations, etc. The \$16,000 received by the Chairperson is his/hers to keep. At that time he or she retires from the "Board" and the "Board" splits down the middle forming two new "Boards". Remember, this is a gift by the New Members. Now that you joined and the "Board" has split you are a Vice President and each new

"Board" has spots for eight New Members. Each time there are eight New Members, the Chairperson receives his/her gifts and you move up again when the Chairperson retires. Three retirement meetings and you are the Chairperson and the next to receive the cash gifts. The average time for a New Member to move to the Chairperson varies, but usually four to eight weeks and often around the six week time-frame. A New Member does NOT give his/her gift until ALL eight New Member positions have been filled.

When you become a Vice President it is recommended that you bring in two new members who hopefully will join and support you. The more potential new members you invite to support your board the faster you will move to Chairperson.

This is not a pyramid. A pyramid by definition is a system of people enrolling into a structure which increases rapidly and on a continuing widening base at the bottom. A pyramid chairperson is a permanent position, they never retire. Our system never gets any larger than the eight new members at the bottom and the Chairperson retires each time there is a retirement meeting.

Can you withdraw? YES! At any time after you become a member or after you have moved to a higher position if you decide you need to leave, it is your option. Usually there is someone who will want to buy your position. Contact your Chairperson or your friend or relative who introduced you to our "Board" and notify them. (This also does not occur in a pyramid situation.)

Sponsorships BEING SPONSORED: If you wish to become a New Member but do not have the funds, you may locate a friend or family member to sponsor you or wait to be sponsored by someone else. The sponsor's name will be on the "Board" with yours and they MUST be with you OR SOMEONE THEY DESIGNATE MUST be with you when you are Chairperson and receive your gifts. You split your retirement gifts with your Sponsor as explained in "RULES" under No. 2. Again, it is recommended that you invite two more people to support you and to keep the board moving.

SPONSORING SOMEONE ELSE: You may wish to join in the networking and the gifting and you may have the funds for your gift but are unable to commit to two meetings a week and therefore may choose to sponsor someone else in need. At the time of their retirement party, YOU OR SOMEONE YOU DESIGNATE MUST be present. Upon receipt of their retirement gifts, they will split the \$16,000 (you will receive \$8,000) and then return your sponsorship gift of \$2,000. Finally it is recommended to keep a balance on your board in keeping the number of people needing sponsorship to a minimum. Boards needing several sponsors tend to move slower.

RULES

1. Membership is by invitation only. The Support Network operates

on TRUST and INTEGRITY. That's why there are only 15 members per "Board". Active members should invite family or close friends, those people whom you would want supporting you.

2. When a person that was sponsored becomes Chairperson and is to receive their gifts, THE SPONSOR OR SOMEONE THE SPONSOR DESIGNATES, MUST be present. After the gifts are received it is split in half, the sponsor receives \$8,000 plus return of the original \$2,000 gift.

3. All members must be at least 18 years of age.

4. All gifts are to be given in cash only. NO personal checks, money orders, or credit cards.

5. Piggybacking or occupying more than one position on the same "Board" is not allowed. If a member is found in violation of this rule, they will be expelled immediately and not allowed back on the "Board".

6. No alcohol or drugs allowed. We want everyone to make informed decisions.

7. Smoking is not permitted at the meetings.

8. No children. This is an adult meeting where we want everyone to relax and be able to think clearly without distractions.

9. Attendance to all meetings or as often as possible is in everyone's best interests to support each other. Keep in mind that you will one day be the Chairperson yourself.

10. CHAIRPERSON OR CEO CONDUCTS MEETINGS AT THEIR HOME (OR SOMEONE ELSE'S THAT MAY OFFER). CONTACTS MEMBERS WITH ALL INFO., SERVES LIGHT SNACKS AT NON-RETIREMENT AND MORE SUBSTANTIAL AT RETIREMENTS. IT IS NOT REQUIRED, BUT IS NICE IF THE CEO HAS "NEW BOARDS READY FOR THE INCOMING CEO'S THE NIGHT OF RETIREMENT AND PASSES ON PERTINENT INFO. SHEETS, ETC.

11. COURTESIES: a. PLEASE BE AWARE OF PARKING. You do not want neighbors to have any reason to complain and bring bad energy to your meetings.

b. Remember, you do not have to join our board in order to use our Networking Board.

Responsibilities

ALL MEMBERS have certain responsibilities. It's important to work together to bring in as many of our trusted family and friends as quickly as possible. The more who join and the quicker, the more opportunities become available to others and the quicker you, move up to the Chairperson position. Often times, meetings have confusion surrounding them and people may forget or not hear clearly about a specific service offered. Having a Network Board, bowl for business cards or "place" to list all the services offered (even handwritten notes about services) will help reduce the confusion and having to search for that person after the meetings.

A CHAIRPERSON:

1. Assists others in benefiting from the opportunities available.

their gift what they might do with it. These introductions need to be kept short, 1-2 minutes so the meetings do not drag too long.

4. Explains the philosophy and rules of the club.

5. Provides simple snacks and drinks for each social.*** A larger more substantial offering is suggested for retirement meeting.

6. Ensures there is no alcohol, smoking, children or other distractions.

QUESTIONS:

1. Must a Chairperson hold the meetings at his/her home? It is the Chairperson's responsibility to hold the meetings, whether at their own home or someone else's.

2. Does the New Member have to be present to give his/her cash gift to the Chairperson? No. The New Member may designate and send a representative in his/her place if he or she is scheduled busy or out of town. However, it is something you would want to attend, if at all possible.

3. Must the Sponsor be present at the retirement meeting? Yes, or they must send a designated representative approved by the Board members.

4. Does the Sponsor have a say about who he/she sponsors? Yes. If you wish to sponsor a specific person, you advise the Club Officers, if you do not then the Chairperson will choose who you will sponsor and put your name below that person's.

IS IT LEGAL? YES!!!!!! ACCORDING TO THE IRS GIFT LAW ANY PERSON MAY GIVE OR RECEIVE A GIFT OF UP TO \$10,000 FROM ANY ONE INDIVIDUAL PER YEAR AND NOT HAVE TO CLAIM IT.

The monetary gifts given in our Support Network do not come close to the \$10,000 limit per person. However, if you wish to claim your prosperity you may do so. If you still have questions about this, consult your tax accountant or lawyer. The gifting received by the Chairperson offers the new members the opportunity to utilize business services provided by other members and guests along with the opportunity for financial advancement through becoming a part of the Support Network. The potential business ~~leads~~ services received can be, in and of themselves, well worth more than \$2,000.

35
3-6

NETWORK CLUB

CEO
Larry *603-939-3*

591-3521

PRESIDENT
Alison *45-221*

PRESIDENT
John *45-221*

cc President
John

591-7196

Vice President
Scott

Vice President
John

591-7196

Vice President
John

43-221

Volunteer

Volunteer

Volunteer

Volunteer

Volunteer

Volunteer

Volunteer

Volunteer

Albania will offer aid to victims of pyramid schemes

The Associated Press

TIRANA, Albania — The government will offer jobs and bank credits to people who have lost money in pyramid schemes that have begun to collapse, President Sali Berisha said Saturday.

"Those who have been affected the most by this activity should be offered employment in the private and public sector...as well as credits to start private businesses," Berisha told leaders of his governing Democratic Party.

Like elsewhere in post-Communist eastern Europe, scams involving fictitious investment companies and charities have popped up in

impoverished Albania, offering sky-high interest rates to people whose average monthly wage is \$60 to \$80. An estimated 500,000 Albanians, almost one in seven of the country's 3.2 million people, have taken part.

Early investors made hefty profits in the funds. But because the funds pay the first investors with the money from later ones, they require a steady stream of new contributors.

Without that they crumble, as in the case of two of Albania's 10 funds that failed to pay out over the last week, sparking demonstrations that quickly turned against the government. Protesters in sev-

eral cities battled police and lobbed stones at government buildings.

Opposition leaders have accused some companies of having financed the Democrats' campaign

for last May's elections, in which they won 122 of the 140 seats in Parliament.

Berisha denied allegations of government involvement.

It is wrong to seek wealth at the expense of others

Dear Editor:

Work is important to life. In fact, the Bible states: "If any would not work, neither should he eat." (11 Thessalonians 3:10) The real danger of the money pyramid "Friends Helping Friends" or "People Helping People" is the danger of receiving something which we have no right to claim. It is wrong to take money from friends and neighbors just for the sake of profit, for "Love does no wrong to a neighbor." (Romans 13: 10) Gambling, in all its forms, tears apart the work ethic. It focuses on getting, not on doing. God wants us to work good with our hands and our lives in order to provide for our needs. The Lutheran Church, just this past summer, made a clear stand against the perils of seeking wealth at the expense of others, specifically, against gambling and money schemes. (Gambling: A report of the Commission on Theology and Church relations of the Lutheran Church Missouri Synod).

While "Friends Helping Friends" sounds appealing. (Yes, I admit it does help the person at the top of the game board to receive money.) simple math makes it clear this is not very helpful for very many. Only one person receives anything, while eight must pay. Those are the rules of the game, and it cannot be changed, no matter how often one plays. It still takes eight people to pay off the one, and this is wrong. There are no services or goods provided.

Christian charity is just that. It is charity. Gift giving with no strings attached. It is friends helping others because of their need and our desire to help them meet their need. Christian charity is based on God's great love for us. We do not attempt to repay God, but we try to imitate His generosity. Not because of our desire to gain money for ourselves, but because we want to share the goodness of God with friends and neighbors around us. This letter simply is a reminder to the people of our community to think and to act with motives that are pure. Good people do good work to treat each other with good.

Sincerely

Rev. Robert W. Grimm
St. John Lutheran Church

Rev. Lawrence J. McDermott
Trinity Lutheran Church

3-8
3-6

The Review's Opinion

Pyramid participants drawn in by greed's true form

The easy-cash pyramid scam that swept through Anderson County the last two weeks has provided a rare opportunity to witness greed in its most pure and coercive form, and to see how it can convince and consume basically good people with little more than a whisper.

A huge profit is a tough temptation to be denied, but one that nonetheless should have been. Come to a secret meeting, hand over \$2,000, and once you and others have convinced 24 other people to come in behind you, you walk out with \$16,000. First names only, please. And bring cash, if you don't mind.

County residents who were immersed in the scam swore up and down that it was legal. How did they know? Because friends who got them involved told them it was legal.

In the words of the current

MTV vernacular: duh?

Of course those who approached new people said it was legal. The people who were already involved had already lost their \$2,000—they'd given it away to someone further up the pyramid—and their obsessive aim was to sell the concept to someone else in order to ensure their own eventual trip to the pyramid's payoff pinnacle.

That salesmanship was employed against family members, close friends, business associates and co-workers. Once they'd taken part in the scheme, new recruits were obliged to hook more of their friends into the deal, or risk not only losing their eventual pay off but their initial \$2,000 stake as well.

This is perhaps the most disturbing aspect of this dirty little game—the fact that people were perjuring their closest relation-

ships in pursuit of money. It was financial vampirism—once bitten, they had to bite others to survive, and those had to bite still others, etc. And they sucked their friends' blood! \$2,000 at a time.

But the reward was the eventual pay off. Imagine walking out of a meeting with \$16,000 in \$100 bills. Those who attended spoke of the nervous excitement that permeated the crowds, and the glee and applause once a "CEO," at the top of the pyramid, "graduated." Under the greed-induced euphoric haze, "graduates" were blinded to the titter impossibility of what had just happened.

Any thinking person knows no one just gives you \$16,000 with no strings attached. It was too good to be true. The money was dirty, the organization illegal, and somewhere, somebody got took.

The selling point of the scheme was that as long as fresh blood

could be attracted to pump in the \$2,000 injections, the scam could go on indefinitely from town to town, state to state. But nothing lives forever. The minute investors ceased to be enticed, the pyramid would fall on the heads of its most recent participants. Their \$2,000 would be safely tucked away in the pocket of some "graduate" somewhere, gone forever. Those who got in and got paid early walked away with large sums of money, which belonged to someone else.

Those who played the game ranged from well-placed members of the community who could easily afford to lose \$2,000, to others who reportedly borrowed money to get involved. Though different, they shared a common ailment. They were encapsulated by greed.

Greed is blinding. Greed is hateful. Greed prostitutes friend-

ship and family ties. Greed forces dilemmas.

Friends now have to decide if their friendships were strong enough to survive losing a large amount of money. They also have to decide whether or not to cooperate with the current law enforcement investigation.

Newspapers also have to decide whether publicizing such a scheme is worth losing the business of clients involved in it. That's a decision we made last week with the announcement of a state investigation. If your newspaper is afraid to publish a real story, for whatever reason, you're reading the wrong paper.

Anderson County will survive the pyramid scheme, but not without some hard lessons being learned. The answer to the question "was it really worth it?" seems abundantly clear.

—Garold Dane Hicks, Publisher

EXHIBIT D

OFFICE OF THE DISTRICT ATTORNEY
Eighteenth Judicial District
Sedgwick County Courthouse
535 N. Main
Wichita, Kansas 67203

NOLA FOULSTON
District Attorney

Consumer Fraud &
Economic Crime Division
(316) 383-7921

February 19, 1997

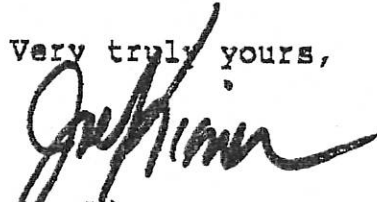
* VIA FAX #913-296-6872 *
David R. Brant
Kansas Securities Commissioner
618 S. Kansas Ave
Topeka, KS 66603-3804

RE: HB 2230 - Prohibiting pyramid promotional schemes

Dear Commissioner Brant:

It is our understanding that the House Sub-Committee on Business, Commerce and Labor will be holding a hearing on Thursday, concerning HB 2230. While I will be unable to appear at the hearing in support of the bill, please feel free to inform the committee of our support for this legislation.

As you know, the statutes need to be clear that such schemes are contrary to the laws of our state and that, when appropriate, those promoting such activities should be subject to prosecution. The District Attorney appreciates and supports your efforts to secure passage of HB 2230.

Very truly yours,

Joe Kisner
Chief Attorney

~~3-7~~
3-10

PYRAMID SCHEME

I. Pyramid scheme in Leroy

A. How

B. Who

1. Kinds of people involved
2. Business people
3. Schools

C. Consequences

1. Negative impact on community

Bill L. Freeman
Owner, First National Bank of LeRoy
Mayor, City of LeRoy

*Business, Commerce
& Labor Committee
2/20/97
Attachment 4*