

THE BONDS THAT TURNED TO DUST

When hedge fund manager Alberto Micalizzi bought bonds backed by oil from an obscure Russian republic he trapped his investors in a secret—and very global—web



REUTERS/RICK SCUTERI

SHELL GAMES: *A Reuters Investigation*

Articles in this series are exploring the extent and impact of corporate secrecy in the U.S.

BY LAURENCE FLETCHER
LONDON, AUG 15

TREASURE SEEKERS HAVE trekked into Arizona's Superstition Mountains in

search of a lost gold mine for more than a century. Three years ago, Italian economics professor Alberto Micalizzi, whose hedge fund was on the verge of collapse, looked to the nearby town of Apache Junction to shore up his own fortune.

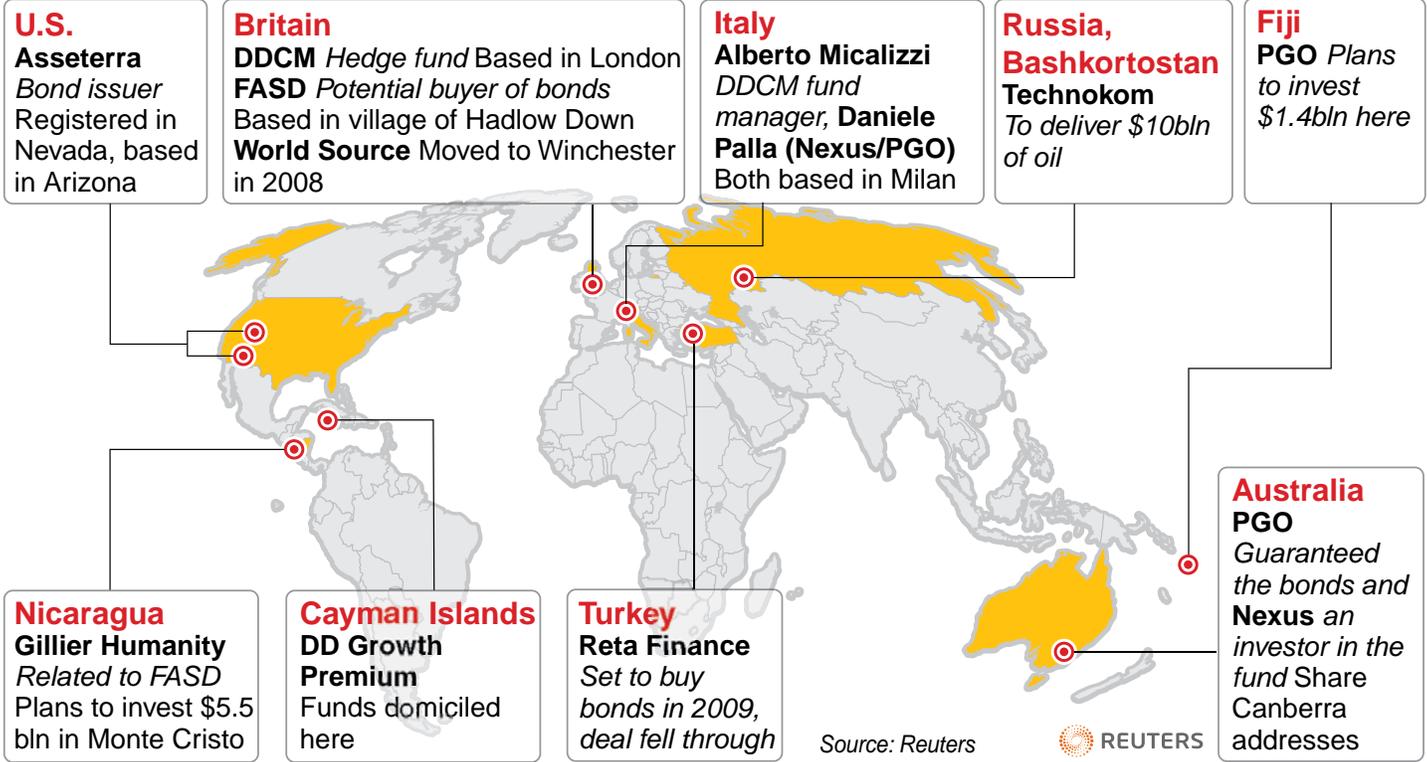
After his fund lost hundreds of millions of dollars in the credit crunch, Micalizzi quietly moved most of its assets into bonds in late 2008.

These were no ordinary bonds.

They were \$500 million of highly illiquid paper purportedly issued by a company in a trailer-park suburb of Phoenix, on behalf of a small Australian commodities firm -- and backed by the proceeds from \$10 billion of diesel from the tiny autonomous Russian republic of Bashkortostan.

The bonds proved to be impossible to sell, and the professor's Cayman Island-

A GLOBAL WEB



based fund, DD Growth Premium, went into liquidation in the spring of 2009. The fund's implosion left behind a band of irate investors and an enduring riddle as to what exactly happened.

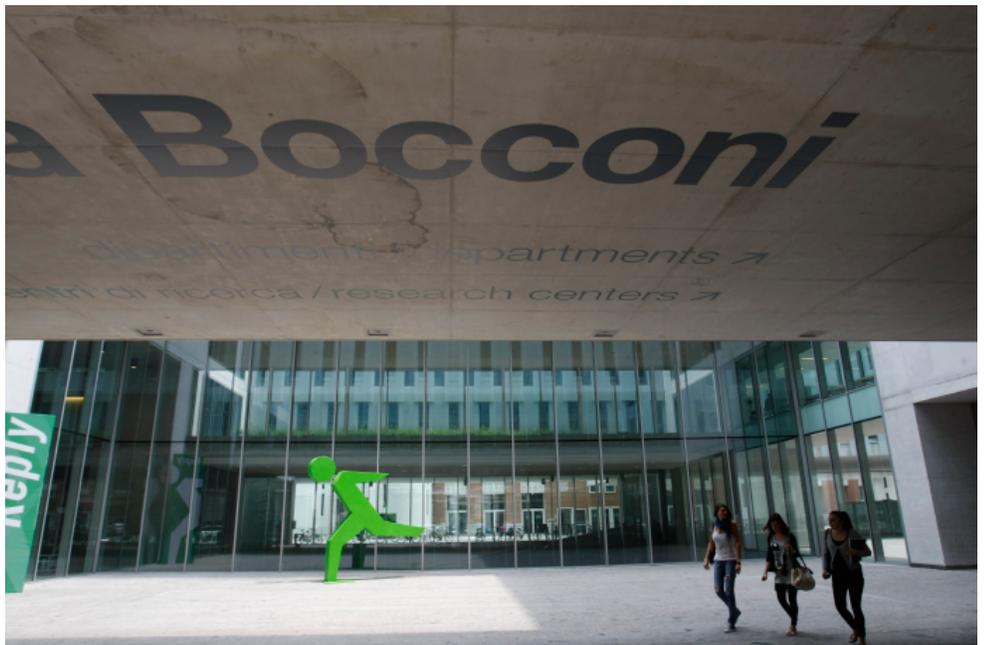
Reuters has followed a paper trail from the fund's offices in the upmarket London neighbourhood of Kensington to the dusty American southwest, from the fund's registered home in a Caribbean tax haven to a suburban house in Canberra, Australia.

The story's cast includes an Arizona businessman on the run from U.S. authorities, a Russian allegedly convicted for theft, and the Italian at the centre of it all: a 42-year-old specialist in options pricing who teaches economics at the respected Bocconi University in Milan.

AMERICAN HAVENS

WHAT EMERGES IS A cautionary tale from the wilds of offshore finance, a lesson to investors about how easy it is to be drawn into a global maze of paper companies with little substance.

Micalizzi's saga shows how America's role in the global proliferation of anonymous shell companies may enable fictitious assets to be magically transformed into real ones for a time, siphoning money from unwitting investors along the way.



TRAINING: Micalizzi teaches economics at Bocconi University in Milan. REUTERS/ALESSANDRO GAROFALO

Since the terrorist attacks of Sept. 11, 2001, the United States has called on other nations to clean up dubious money flows. International watchdogs such as the Financial Action Task Force are urging all countries to collect data on the real owners of corporations. The goal: reduce the movement of illicit funds by shining

a brighter light on so-called beneficiaries, who can use shell companies to open bank accounts, hide assets or create fake ones, and avoid taxes.

But few countries have acted.

The United States itself has allowed several states to emerge as secrecy havens -- including Nevada, where the Arizona-based

company behind Micalizzi's bond mystery is formally incorporated. Nevada state law allows "nominees" to be appointed in place of real directors and officers, making it harder to detect who is behind companies.

The deal's global paper trail, compiled from corporate registries and legal records as well as documents and emails supplied by a person with close knowledge of the situation, led Reuters to a half dozen companies.

Some were incorporated in one jurisdiction while listing business addresses in another, a common shell company strategy, according to law-enforcement officials and private investigators. In almost every case in which Reuters reporters knocked on the doors of firms that were said to be managing the massive oil-backed debt deal, however, nobody answered.

INVESTIGATION REOPENED

MICALIZZI HAS NOT BEEN charged with any crime. UK investigators dropped a probe in July 2010, saying it would "not produce

evidence sufficient to give rise to a realistic prospect of conviction."

But a judge in an Irish civil lawsuit between two investors in one of Micalizzi's funds last year ruled the Italian had knowingly given a false picture to investors. He had, the judge found, set up "a fraudulent scheme" to persuade one to invest in order to pay off another -- akin to a Ponzi scheme.

Reuters has also learned that the Financial Services Authority, which regulates Britain's financial industry, earlier this year reopened its investigation into "the provenance and value of the ... bonds".

Micalizzi declined to be interviewed for this story, saying in a June email to Reuters that "since the last wave of unfounded speculations raised against me and my company, which happened during 2009, there is nothing news as far as I am concerned".

For investors hoping to get some of their cash back, though, there are still plenty of questions to answer. Does the oil that backs the bonds exist? Who are the people behind the bonds? And what

exactly are their connections to Micalizzi?

A CHANGE OF POLICY

THE MONEY TRAIL BEGINS in London's Kensington, where Micalizzi, an expert in options pricing, started his firm, Dynamic Decisions Capital Management (DDCM), in 2004. The equity fund used a strategy of pairs trading -- matching long positions in one stock with short positions in others to try to make money whether the market was rising or falling.

The fund's directors included Michael Nobel, great-grandnephew of the founder of the Nobel Prize. It pulled in big name investors such as RMF, which is part of Man Group, the world's biggest listed hedge fund manager, London-based Strathmore, and a subsidiary of the Ontario Teachers' Pension Plan Board.

The fund used a master-feeder structure, a set-up employed by many hedge fund managers. A master fund -- the DD Growth Premium Master Fund -- was fed by smaller ones. DDCM mostly picked large-cap U.S. and European equities, and limited any single position to 6 percent of assets.

"WE DID SEE A SALES AGREEMENT, WHICH LOOKED ENTIRELY BOGUS TO ME."



ROUGH PEAK: The Superstition Mountains outside Apache Junction, the last known address for David Spargo and his company Asseterra. **REUTERS/RICK SCUTERI**

But in late 2008, as the financial crisis was wrecking investments around the world, it unexpectedly moved most of its assets into bonds. These unusual instruments were part of an issue of highly illiquid paper that ostensibly gave rights to future deliveries of up to \$10 billion worth of diesel fuel from Bashkortostan in the Ural Mountains.

'SUBSTANTIAL LOSSES'

IN JANUARY 2009, Micalizzi wrote to investors that the previous year had been one of "continued success" despite market turbulence. He told them assets in the two feeders had expanded to \$475 million from \$360 million, and outlined plans to increase the transparency of the fund's positions and launch two new ones.

"I feel each of the shocks from 2008 strengthened our organisation," he wrote.

The fund finally revealed the extent of its problems in March 2009. In a conference call for investors, DDCM Director Humphrey Polanen acknowledged that "substantial trading losses" meant total assets were actually only \$20-\$30 million. According to a KPMG investigation ordered by DDCM directors, the fund's losses on options trading were \$250 million between August and

"TOTAL NONSENSE. IT'S A SCAM."

November 2008 alone.

What's more, the "substantial losses" incurred in 2008 "were concealed from the investors," wrote financial consultancy Zolfo Cooper, which was appointed liquidator of one of the feeder funds, in a May 2009 report, a copy of which was reviewed by Reuters.

Investors and outside directors were irate. "In 2008 things looked to me to be going rather well as the overall rates of return seemed satisfactory in light of the general economic situation," director Michael Nobel told Reuters. "The next we know, the thing had imploded. We had not been kept abreast of what he'd done. We did see a purchase and sales agreement, which looked entirely bogus to me, with weird names and fancy coats of arms. It was very, very unreliable -- that was the general consensus of the external board."

Asked where he thought the money had gone, Nobel said: "That's an excellent question. I wish I could give you a good answer... We asked the same question and never got a clear answer."

RESORT IN FIJI

THE MYSTERIOUS CHARITY BEHIND MICALIZZI'S BONDS

BY LAURENCE FLETCHER

THE SPANISH-BASED CHARITY behind the \$10 billion in oil futures that backed Alberto Micalizzi's bonds has an ambitious motto. "We are responsible for everything which is taking place in this World!" reads a slogan on its website.

Despite that ambition, and offices in countries including the United States and Australia, the International Charitable Christian Fund (ICCF) has almost no public profile, and evidence of its humanitarian work is hard to come by.

The group, headed by alleged Russian criminal Vladimir Kobzar, is headquartered in the tiny seaside town of La Mora, between Barcelona and Tarragona. A Google satellite search suggests ICCF is located on a tree-lined street of large houses, most with swimming pools.

The charity's U.S. office, on a suburban road in Chicopee, Massachusetts, is headed by a different Kobzar: Vasiliy. It counts a further four Kobzars as directors.

According to the U.S. branch's articles of association -- the only document filed since ICCF was set up there 10 years ago -- "the main purpose of this corporation is the dissemination and propaganda of the Christian ideals, provision of the humanitarian, medical and moral assistance to all people who has such needs (sic)."

To achieve those aims, the articles state, ICCF will need to undertake the "creation of different companies and organisations... possession and use of the land, other natural resources and real estate".

Just what those companies or

organisations do is unclear: the charity's U.S. phone number was unobtainable. In a telephone interview, Irina Bekhtina, who works with Kobzar at ICCF in Spain, declined to detail any of the charity's work.

Bekhtina said she has known Kobzar since 1994 and denied reports of his criminal past.

"(It's) not at all the truth," she said. "Vladimir has been in prison for one year in the '80s for nothing, there was no case of accusation." The experience, she said, helped "train him to be strong, to be very precise ... Our organisation is totally clean. All of (the reports) were lies."

Bekhtina told Reuters Kobzar was responsible for "big assets from the Soviet Union, Russia and now some global positions" and had been "checked by central banks", although she declined to say which.

In a July 2007 letter from ICCF to Russian President Vladimir Putin, the charity proposed making the rouble the main global currency. It also said it had support from African, European and Latin American countries to write off Russian debt and work on a modified Marshall plan.

Kobzar, Bekhtina said, "has special global immunity numbers confirmed by the United Nations.

"Be very careful. Someone is trying to stop us in our movements ... Vladimir has a very high level in the financial world ... He's responsible for many big assets, he has a special assignment for this but it's closed information. He has the rights to deal with heads (of countries). Everything he does is for the benefit of humankind." ■

(Additional reporting by Anna Andrianova in Moscow)

INVESTORS BECAME EVEN more concerned when they looked into the origin of the bonds, whose coupon and principal payments were meant to be guaranteed by oil futures, and which could be converted into either physical oil or cash.

A copy of the offer document for the bonds, shown to Reuters by the source with close knowledge of the situation, contains a number of red flags.

The document, from a U.S.-based company, told of vague plans to spend the \$10 billion on "the purchase of lands, commodities and other related business." Almost \$4 billion was

earmarked for the "first grassroots U.S. refinery in 30 years" and a crude oil delivery system. Almost \$2 billion would go to a "waste-to-ultra clean fuel-power project". \$1.4 billion was headed for a five-star resort in Fiji.

Reuters asked Paul Barnes, professor of Fraud Risk Management and Director of the International Fraud Prevention Research Centre at Nottingham Business School, to examine the offer document. His response: "total nonsense, it's a scam."

The document, Barnes said, is "cobbled together with information that's largely

irrelevant to give the impression of seriousness. Because it's global, it's as if it transcends all regulatory regimes. The big numbers do not impress me as an investor as I can't see the security behind the bonds. The fact they're asking for a lot of money may be a way of gaining credibility."

'GENUINE AND VALUABLE'

THE TWO FEEDER FUNDS and the Master fund were put into liquidation in March and April 2009; the board removed Micalizzi and prohibited him from talking to investors. Even after he was fired, the Italian maintained the bonds were a great buy. He had bought them "to temporarily ride out the storm", he wrote in an April 2009 statement. "It is my honest belief that the bonds are genuine and have value, and can still be sold as to pay out redeeming investors and creditors in whole or in part."

The purchase was nonetheless unusual. According to liquidator Zolfo Cooper, DDCM's Master Fund had bought U.S. \$700 million worth of paper for just \$310 million from an Australian company called Pacific Global Oil Australia Pty Ltd (PGO).

Micalizzi said he planned to sell the bonds on immediately. But when he couldn't find a buyer, the fund resold half the bonds -- \$350 million worth -- back to PGO for \$305 million, plus a \$31 million fee for acting as distributor of the bonds.

This left DDCM holding bonds with a face value of \$350 million for which it had paid just \$5 million. At the same time, another Australian company closely related to PGO, called Nexus Management, gave DDCM \$150 million worth

of the same oil-backed bonds in return for a \$75 million stake in the fund, in a transaction directly authorised by the fund's directors.

Netting it out, and including a \$1.25 million listing fee, Micalizzi and DDCM had spent just \$6.25 million and given away a stake in the fund worth \$75 million, according to Reuters calculations. In return, it had become the owner of bonds with a face value of half a billion dollars.

The bonds were then added to the fund's balance sheet at the end of 2008 with a value of \$462.4 million.

Fund administrator PNC, now part of BNY Mellon, was responsible for preparing financial statements for the fund. It declined to comment, other than to confirm its role.

Daniele Palla, an Italian commodities trader, says he is a representative of PGO. He told Reuters Micalizzi had signed purchase agreements with PGO to buy \$500 million of bonds and made a down-payment of \$5 million. When he didn't pay the full amount, however, the bonds were cancelled.

"He (Micalizzi) cheated us," said Palla. "He signed the contract, purchased a number of bonds and he didn't pay for it. He defaulted on it.... Both PGO and Nexus are victims of this situation."

RAISING ARIZONA

THE BONDS' HISTORY IS perplexing. They were originally issued in 2008 by a tiny company called Asseterra Inc., based in the small town of Apache Junction, Arizona, and incorporated in Nevada.

Asseterra's president, chief executive,

secretary, director and treasurer is David Spargo. He has run two other firms from the same address as Asseterra. One of these, a venture capital firm, was shut down last year when it failed to file accounts and ran into trouble over a bond issue, according to U.S. federal court records.

Asseterra said when it issued the bonds it was acting on behalf of Pacific Global Oil. But liquidators Zolfo Cooper said in a report to creditors Asseterra was in fact a special purpose vehicle set up by Pacific Global Oil to issue them.

According to public records and interviews by Reuters, Spargo did in fact set up a physical location for Asseterra -- in an Apache Junction strip mall located on Superstition Boulevard, next door to The Dog Run Saloon and one block from the local police station.

A property manager for the suite says Spargo listed another firm, Napis Inc., as the resident business and always paid his rent on time until the lease expired in December 2009.

Nobody interviewed by Reuters in Apache Junction over two days, including four city and county government officials and executives from businesses located nearby, had heard of Asseterra Inc.

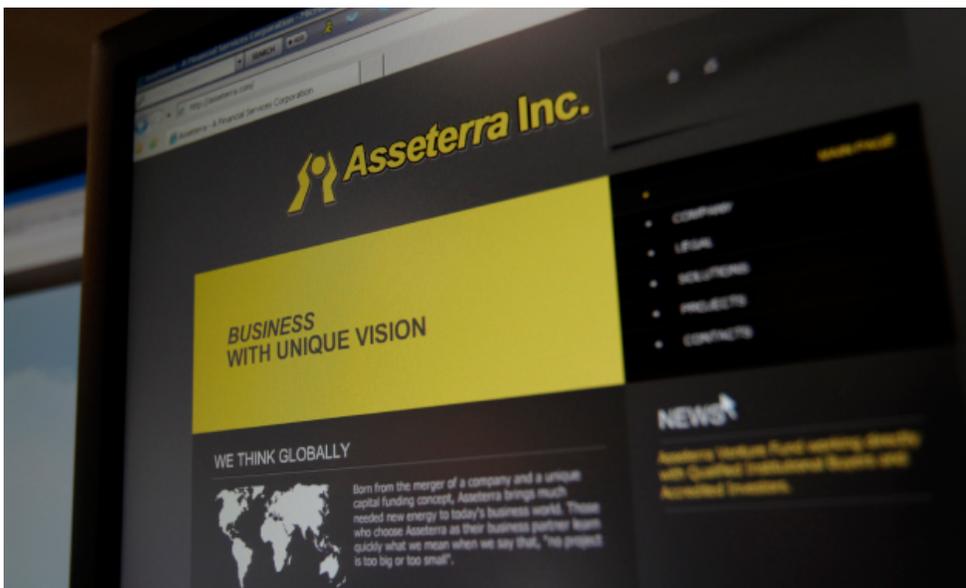
Asseterra's base of Apache Junction, population 37,000, is a fringe suburb of trailer parks and sand about 35 miles east of Phoenix. The town is home to a grassless golf course called the Snakehole and serves as the launch pad for people searching for the Lost Dutchman Gold Mine. Residents say no gold has ever been found.

MISSING MONEY MAN

PROPERTY RECORDS INDICATE Spargo lives on Saguaro Drive just north of town. A visit by a Reuters reporter showed the property is a vacant lot with a no-trespassing sign and some cactus. A separate address for Spargo in Mesa, Arizona, is a stucco home which went into foreclosure last year.

In January 2009, a federal judge in Arizona ordered Spargo's Napis Inc. to repay \$5.5 million to investors in bonds that the company had said it would register for sale in Luxembourg, according to documents in three separate lawsuits in Texas, Virginia and Arizona filed since 2006 and related to the judgment. It is unclear what assets backed the bonds. The investors alleged in the lawsuits that they were defrauded by other companies which used their funds to buy the dubious Napis-issued paper.

For two years, Napis and Spargo refused to pay the judgment and have not responded to



PROMISES: The Asseterra website boasts of spending \$10 billion on everything from an oil refinery to a five star resort in Fiji. **REUTERS/SIMON NEWMAN**

requests for documents. On Jan. 5, the Arizona court issued a warrant for Spargo's arrest on a contempt charge in the case, according to court records.

Spargo has not been seen since. Philip Rudd, an attorney for one of the plaintiffs in the case, says he is believed to have left the country. Spargo's wife, Karen, could not be located for comment.

Spargo did not respond to requests for comment from Reuters sent to an email address for Asseterra. Three Arizona attorneys who represented him in the Napis case resigned in October 2009. They did not respond to requests for comment. Michael Kessler, an attorney for Spargo in a Texas lawsuit related to the judgment, did not respond to a request for comment.

'SUBJECT OF SOME CONTROVERSY'

LIKE ASSETERRA, Canberra-based Pacific Global Oil is a company that leaves little trace of its existence. In documents relating to the bond deal, the firm describes itself as "a premier provider of commodities solutions."

But its quoted fax and phone numbers "have proved to be unobtainable and information provided by Micalizzi regarding PGO has proved to be inaccurate," according to liquidators Zolfo Cooper.

"The liquidators consider it surprising that PGO had guaranteed bonds over \$10 billion but had a capital of just AUS \$1,000 and in addition PGO do not appear to have engaged either lawyers or accountants in relation to the issue of the bonds," Zolfo Cooper said.

PGO is closely linked to Nexus Management, the company which gave \$150 million worth of oil-backed bonds to DD Growth Premium Master fund in return for a \$75 million stake. Both firms share the same address as their head office and principal place of business -- a residential block of flats in Canberra.

Reuters visited all three of Nexus's Canberra offices but found little evidence of the company. At one address -- a house in a well-to-do suburb -- movement could be heard inside, but nobody answered the door on repeated visits. The lawn had been mowed and the mail collected, but the listed phone number did not work.

The judge in last year's case in Ireland -- it pitted one investor in a DDCM fund against another rather than against Micalizzi -- said a possible connection between Nexus and the Italian professor is "not clear and the subject of some controversy." The judge speculated that Nexus might be "a genuine party" or else "simply a vehicle either controlled by Dr Micalizzi or, although independently controlled



BASIC: The Technokom Oil website offers few clues about the company. REUTERS/SIMON NEWMAN

*"IF SOMETHING ARRIVES
ON MY DESK, IF IT'S
GENUINE, 100 PERCENT,
I PROCEED. IF IT'S NOT, I
WALK AWAY."*

... happy to work along with Dr Micalizzi."

Nexus's main representative in its dealings with DDCM was Italian commodities trader Palla, whose company, World Source Group, is registered in the United Arab Emirates and describes itself as "a leader in the commodities world market." World Source Group was the sales agent for the Asseterra bonds, meaning it was supposed to sell the oil futures on the market if the holder chose to convert them.

However, when contacted by Reuters, Palla said WorldSource was dormant and had moved its operations to the UK. A company search showed it had shareholder funds last year of 736 pounds (\$1,200).

Palla said the bonds themselves were genuine. "I base all my activities on the facts, things that are verifiable in black and white, such as these documents. If something arrives on my desk, if it's genuine, 100 percent, I proceed. If it's not, I walk away."

CHARITY BEGINS IN SPAIN?

REUTERS WAS UNABLE TO verify whether the oil futures backing the bonds are black and white fact.

According to a KPMG investigation, the diesel is to be delivered by a company called Technokom in Bashkortostan. Technokom's

website offers only an email address as a means of contact, but the company did not respond to requests for comment.

A deed of assignment seen by Reuters shows the oil futures originally came from a Spanish-based charity, the International Charitable Christian Fund (ICCF), which boasts on its website that it is "responsible for everything which is taking place in this world" (see page 4).

On the deed, ICCF says it has operations in countries including Russia, the United States, Australia and Costa Rica. It is not registered in Spain as a foundation, although it is listed at the National Companies Register, where its activity is stated as "the purchase, sale and management of real estate." The register also indicates that ICCF has equity of 3,200 euros (\$4,575).

ICCF is run by a Russian businessman named Vladimir Kobzar, who also turns out to be a 25 percent shareholder in Canberra-based Pacific Global Oil.

German magazine Focus has reported that ICCF faced allegations of money-laundering in the mid-2000s after trying to provide financing for a Dresden-based engineering company. Columbian radio station Caracol reported in 2006 that the Russian embassy in Bolivia had issued a warning against ICCF and Kobzar over an attempted scam.

A 2002 report in the Russian newspaper Vremya Novostei says Kobzar spent more than a decade in jail for theft. In 1996 and 1997, ICCF offered the Russian government and a number of regional authorities long-term loans that paid 7 percent a year interest, according to the paper. In return, Moscow and the regions would issue a 'veksel' -- an 'I owe you' -- backed by the property of Russian companies. ICCF said it

would then give every Russian citizen \$50,000.

'A GOOD BOY'

RUSSIAN SPECIAL SERVICES concluded ICCF's bonds did not exist, according to the paper, and warned regional governments to beware. Kobzar was later involved in another fraud attempt, the paper says, before having an "explanatory meeting" with Russian special services.

Reuters could not independently verify his criminal conviction -- official records in Russia from that period are often difficult to obtain -- and was not able to contact Kobzar directly. But Irina Bekhtina, who also works at ICCF in Spain, played down the reports of Kobzar's alleged criminal past.

"(It's) not at all the truth," she told Reuters. "Vladimir has been in prison for one year in the '80s for nothing, there was no case of accusation." The experience, she said, helped "train him to be strong, to be very precise ... Our organisation is totally clean. All of (the reports) were lies."

Nexus's Palla also defends Kobzar, saying the Russian had been approached by PGO after an introduction through an intermediary.

"He's a good boy, despite what you see on the internet," Palla told Reuters. "Prior to talking, Mr. Kobzar always proves what he's going to talk about... I don't know much about his past."

PROBE GOES NOWHERE

IN LATE 2009, UNDER pressure from investors, the UK's Financial Services Authority referred the DDCM case to the Serious Fraud Office, which launched a criminal investigation.

Eight months later the office decided there wasn't enough evidence to prosecute. Minutes from a stakeholder meeting held by Zolfo Cooper in 2010 say the SFO "indicated that they had not received much support from

"I AM NOW GOING AFTER THOSE WHO HAVE DEFAMED ME. THAT'S WHAT IS LEFT ABOUT THE PAST AS FAR AS I AM CONCERNED."

investors" for the probe.

Reuters has found some key parties -- including Zolfo Cooper -- offered to help but were not contacted by the Serious Fraud Office. Reuters presented the office with its findings and offered to discuss the documents it uncovered, but the SFO has so far not taken

up this offer.

The SFO, whose resource budget has been cut by 34 percent since 2008-2009, declined to comment for this story.

Complicating investors' attempts to investigate DDCM is the company's domicile in the Cayman Islands. The tax haven is the world's fifth-largest financial centre and hosts almost two-thirds of the world's hedge funds. But its secrecy laws are tight.

One reason investors may have been reluctant to help the investigators could be the hope Micalizzi can still sell the bonds and repay his clients. The Italian told Reuters in November 2009 that there was "an interesting opportunity to sell all the assets to one buyer". Contracts for the sale of the bonds were even signed on 31 Dec. 2009 with a Turkish corporation called Reta Finance, introduced to the liquidators of the Master Fund by Micalizzi.

'SMOKE AND MIRRORS'

RETA WAS APPARENTLY ready to pay \$465 million. But Micalizzi, whose firm stood to make two percent of the sale for finding a buyer, also wanted to be released from all liability relating to the funds. The sale fell through.

Attempts to sell the bonds have continued. So far, though, no one is buying.

"Thank God we didn't," says an official at Dubai-based Lootah Farazad Investments, which looked at the bonds before declining. "They were smoke and mirrors."

With nobody prepared to buy the bonds, DDCM's liquidators and some investors are beginning to agitate for options, including lawsuits.

Micalizzi, too, says he is gearing up for legal action. "I am now going after those who have defamed me," he wrote in his June email to Reuters. "That's what is left about the past, as far as I am concerned.

"I truly do not understand your interest in my case. I have to tell you that you are the only one that is still asking questions to me." ■

(Additional reporting by Brian Grow in Apache Junction, Ariz., Rob Taylor in Canberra, Sonali Paul in Melbourne, Robert Hetz and Judy MacInnes in Madrid, Jim Christie in San Francisco, Nicholas Vinocur in Paris, Guy Falconbridge in Moscow, Danilo Masoni, Emilio Parodi and Nigel Tutt in Milan, Alejandro Lifschitz in Buenos Aires, Alonso Soto in Santiago, Terry Wade in Lima, Carlos Quiroga in La Paz, Shurna Robbins in the Cayman Islands, Cecilia Valente and Kirstin Ridley in London; Editing by Simon Robinson, Sara Ledwith and Michael Williams)

A MODERN DAY MONACO

BY LAURENCE FLETCHER

FASD, BASED IN THE small village of Hadlow Down in southern England, is one company that has shown interest in the bonds. On its website, FASD says its mission "is to find and manage financially rewarding alternative investment options for those accredited and experienced clients who want to grow their financial wealth as well as participate in global humanitarian projects".

Wim Van Hooydonk, FASD's chairman and director, told Reuters in a telephone interview he didn't "want anything to do with these bonds. Somebody from Italy, a certain professor, has mixed us up in these transactions, and we don't want to be involved in these transactions at all."

But correspondence seen by Reuters between Van Hooydonk and Grant Thornton, liquidators of the DDCM Master fund, indicates he had been very keen. "We remain totally committed to complete the transaction and confirm that the first payment is going to be completely (sic) quite shortly, very likely before the end of the week," said an Oct. 2010 mail.

FASD has very close links to a charitable foundation headed by Bruno Gillier called Gillier Humanity which is, according to its website, "dedicated to making a positive impact on the quality of life" in places such as Tahiti, Fiji and Thailand.

Gillier Humanity plans to spend at least \$385 billion to create hundreds of thousands of jobs around the world. The charity says it wants to buy two or three airlines, a top 10 hotel or resort operator, and banks. Gillier also plans to spend \$5.5 billion to transform the 400-acre Nicaraguan province of Monte Cristo into a "modern day Monaco".

"Monte Cristeau (sic) is the same physical size as Monaco and will have a similar economy, government and infrastructure," read Gillier's plans. "Gillier Humanity will develop the following: set up the desired form of government (constitutional monarchy), with heads of state and ambassadors, create a constitution, flag, banking system with gold-backed currency, have international embassies and consulate offices worldwide, and offer diplomatic missions and diplomatic immunity." ■

INSIDE "SECRECY JURISDICTIONS"

BY SARA LEDWITH

ALBERTO MICALIZZI BASED his company in London but its funds were registered in the Cayman Islands, one of the favourite places in the world for the seriously wealthy to park their money. According to Nicholas Shaxson, a journalist and researcher for the Tax Justice Network, we ignore the Caymans and other financial playgrounds such as Jersey or Switzerland at our peril.

Shaxson's book, "Treasure Islands", published earlier this year, is a polemic that argues that the global web of 60 or so "secrecy jurisdictions" -- including Delaware, Panama, Ireland, the City of London, the Netherlands, and Mauritius -- hides several trillion dollars, a vast criminal economy, and plenty of repression.

Saddam Hussein, Silvio Berlusconi, Kim Jong-Il and Bono -- as well as most multinationals, banks and hedge funds -- have all made use of offshore havens, Shaxson says.

He argues that they foster a no-man's land where the proceeds of crime are handled as easily as legitimate flows. In today's offshore world, jurisdictions compete to lower the regulatory bar. One result: the rich get richer, and inequality increases.

Conspiracy theorists will enjoy "Treasure Islands". Though its assertions about crime suffer from a lack of specific examples, the book raises serious questions about what Shaxson, a former Reuters journalist, calls "the great untold story about big finance and the supremely powerful weapon it has deployed in its battle to capture political power around the world."

Besides evoking repressive insularity on the island of Jersey, Shaxson hones in on the



HAVEN: Tourists arrive in the Cayman Islands, the Caribbean "secrecy jurisdiction" where DDCM's funds were registered. REUTERS/GARY HERSHORN

Corporation of London, the "state within a state" that lies behind the City, as London's financial centre is known. The Corporation predates parliament and has sent its own representative -- the ominously named "remembrancer" -- to Britain's lower house since 1571. His mission: to remind the monarch of their debt.

Political parties have abandoned pledges to abolish the Corporation, which runs funds including City Cash, "a private fund built up over the last eight centuries". It will never give any account of its assets, "because as a City established from time immemorial which has

never been in debt, we are not required to give any public accounting."

According to the book, a London journalist's efforts to use Freedom of Information requests to learn more about the Corporation's cash have been legally thwarted.

"It is time for the great global debate about tax havens to begin in earnest," Shaxson writes. "If we do not act together to contain and control financial secrecy then ... a tiny few will have their boots washed in champagne while the rest of us struggle for our lives in conditions of steepening inequality." ■

COVER PHOTO: The Superstition Mountain Museum close to the last known address for David Spargo and his company Asseterra in Apache Junction, Arizona, July 2011. REUTERS/RICK SCUTERI

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A LITTLE HOUSE OF SECRETS ON THE GREAT PLAINS

One home in Wyoming plays host to 2,000 companies. It's part of an industry that sells the very secrecy Washington urges others to stamp out.



REUTERS/KELLY CARR

BY KELLY CARR AND BRIAN GROW
CHEYENNE/ATLANTA, JUNE 28

THE SECRETIVE BUSINESS havens of Cyprus and the Cayman Islands face a potent rival: Cheyenne, Wyoming.

At a single address in this sleepy city of 60,000 people, more than 2,000 companies are registered. The building, 2710 Thomes Avenue, isn't a shimmering skyscraper filled

SHELL GAMES: *A Reuters Investigation*

Articles in this series are exploring the extent and impact of corporate secrecy in the U.S.

with A-list corporations. It's a 1,700-square-foot brick house with a manicured lawn, a few blocks from the State Capitol.

Neighbors say they see little activity there besides regular mail deliveries and a woman who steps outside for smoke breaks.

Inside, however, the walls of the main room are covered floor to ceiling with numbered mailboxes labeled as corporate "suites." A bulky copy machine sits in the kitchen. In the living room, a woman in a headset answers calls and sorts bushels of mail.

A Reuters investigation has found the house at 2710 Thomes Avenue serves as a little Cayman Island on the Great Plains. It is the headquarters for Wyoming Corporate

Services, a business-incorporation specialist that establishes firms which can be used as “shell” companies, paper entities able to hide assets.

Wyoming Corporate Services will help clients create a company, and more: set up a bank account for it; add a lawyer as a corporate director to invoke attorney-client privilege; even appoint stand-in directors and officers as high as CEO. Among its offerings is a variety of shell known as a “shelf” company, which comes with years of regulatory filings behind it, lending a greater feeling of solidity.

“A corporation is a legal person created by state statute that can be used as a fall guy, a servant, a good friend or a decoy,” the company’s website boasts. “A person you control... yet cannot be held accountable for its actions. Imagine the possibilities!”

Among the entities registered at 2710 Thomes, Reuters found, is a shelf company sheltering real-estate assets controlled by a jailed former prime minister of Ukraine, according to allegations made by a political rival in a federal court in California.

The owner of another shelf company at the address was indicted in April for allegedly helping online-poker operators evade a U.S. ban on Internet gambling. The owner of two other firms there was banned from government contracting in January for selling counterfeit truck parts to the Pentagon.

CASTING THE FIRST STONE

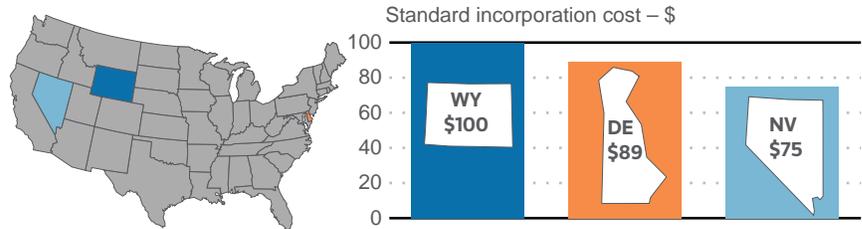
ALL THE ACTIVITY at 2710 Thomes is part of a little-noticed industry in the U.S.: the mass production of paper businesses. Scores of mass incorporators like Wyoming Corporate Services have set up shop. The hotbeds of the industry are three states with a light regulatory touch—Delaware, Wyoming and Nevada.

The pervasiveness of corporate secrecy on America’s shores stands in stark contrast to Washington’s message to the rest of the world. Since the Sept. 11 attacks in 2001, the U.S. has been calling forcefully for greater transparency in global transactions, to lift the veil on shadowy money flows. During a debate in 2008, presidential candidate Barack Obama singled out Uglund House in the Cayman Islands, reportedly home to some 12,000 offshore corporations, as “either the biggest building or the biggest tax scam on record.”

Yet on U.S. soil, similar activity is perfectly legal. The incorporation industry, overseen by officials in the 50 states, has few rules. Convicted felons can operate firms which create companies, and buy them with no

America’s Havens of Anonymity

How U.S. incorporation services sell low taxes, minimal fees, and ownership anonymity in three key states.



	WY	DE	NV
State corporate income tax	No	Yes*	No
Personal income tax	No	Yes	No
Allow nominee company officers	Yes	Yes	Yes
Allow nominee company shareholders	Yes	Yes	Yes
Allow one-person corporations	Yes	Yes	Yes
Meetings can be held anywhere	Yes	Yes	Yes
Nominal annual fees	Yes	Yes	Yes

* If the company has operations in the state
 Source: Delaware Division of Corporations, Nevada Secretary of State Office, Wyoming Secretary of State’s website, Wyoming Statute



Reuters graphic/Stephen Culp

15/06/11

background checks.

No states license mass incorporators, and only a few require them to formally register with state authorities. None collect the names and addresses of “beneficial owners,” the individuals with a controlling interest in corporations, according to a 2009 report by the National Association of Secretaries of State, a group for state officials overseeing incorporation. Wyoming and Nevada allow the real owners of corporations to hide behind “nominee” officers and directors with no direct role in the business, often executives of the mass incorporator.

“In the U.S., (business incorporation) is completely unregulated,” says Jason Sharman, a professor at Griffith University in Nathan, Australia, who is preparing a study for the World Bank on corporate formation worldwide. “Somalia has slightly higher standards than Wyoming and Nevada.”

An estimated 2 million corporations and limited liability companies are created each year in the U.S., according to Senate investigators. The Treasury Department has singled out LLCs as particularly vulnerable to being used as shell companies, as they can be owned by anyone and managed

anonymously. Delaware, Nevada and Wyoming had 688,000 LLCs on file in 2009, up from 624,000 in 2007.

Treasury and state banking regulators say banks have flagged billions of dollars in suspicious transactions involving U.S. shell companies in recent years. On June 10, a federal judge in Oregon ordered a company registered there to pay \$60 million for defrauding a Ukrainian government agency through sham transactions involving shell companies. The civil lawsuit described a network of U.S.-registered shells connected to fraud in Eastern Europe and Afghanistan.

A growing niche in the shell business is shelf corporations. Like paper-only shells, which enable the secrecy-minded to hide real ownership of assets, shelf companies are set up by firms like Wyoming Corporate Services, then left “on the shelf” to season for years. They’re then sold later to owners looking for a quick way to secure bank loans, bid on contracts, and project financial stability. To speed up business activity, shelf corporations can often be purchased with established bank accounts, credit histories and tax returns filed with the Internal Revenue Service.

“They just slot in your names, and you walk

BLOG

Find more Reuters special reports at our blog The Deep End here:

<http://link.reuters.com/heq72q>

away with the company. Presto!" says Daniel E. Karson, executive managing director at investigative firm Kroll Inc. "The purpose is to conceal ownership."

On its website, Wyoming Corporate Services currently lists more than 700 shelf companies for sale in 37 states. The older they are, the more expensive, like Scotch whisky. Brookside Management Inc., formed in December 2004, sells for \$5,995, while Knotty Management LLC, formed in May, costs just \$645. In Delaware, incorporator Harvard Business Services markets First Family LLC, created in May 1997, for \$10,000.

"If they're signing a large contract, they may not want it to look like they've just formed a company," said Brett Melson, director of U.S. sales at Harvard Business Services. But he added: "Unsavory characters can do a lot of bad things with the companies."

Shell and shelf companies do serve legitimate purposes. They provide a quick and cheap way for entrepreneurs to jump into business and create jobs. Businesses can use them to protect trade secrets. Politicians or other public figures may use a shell company to hold their home so that people with ill intent have a harder time locating them.

The state of Wyoming says it cracked down on incorporation services in 2009 after discovering that nearly 5,700 companies were registered to post-office boxes. New laws require companies to have a physical presence in the state through an owner or a registered agent, and make it a felony to submit false filings.

"What we want to have is good, quality legitimate businesses," said Patricia O'Brien, Wyoming's Deputy Secretary of State. "We don't regulate what the business itself does, but we are not recruiting businesses here that are questionable or illegal."

Wyoming Corporate Services is run by Gerald Pitts, its 54-year-old founder and president. On paper, he is a prolific businessman. Incorporation data provided by Westlaw, a unit of Thomson Reuters, show that Pitts is listed as a director, president or principal for at least 41 companies registered at 2710 Thomes Avenue.

Another 248 firms name Edge Financial

REUTERS INSIDER

HUB OF SECRETS: WYOMING



Click here for video from Cheyenne, Wyoming:
<http://link.reuters.com/saf42s>

Inc., another incorporation service, as their "manager." Gerald Pitts is the president of Edge Financial, according to records on file with the Wyoming secretary of state's office.

Companies registered at 2710 Thomes Avenue have been named in a dozen civil lawsuits alleging unpaid taxes, securities fraud and trademark infringement since 2007, a review of Westlaw data shows. State and federal tax authorities have filed liens against companies registered at the address seeking to collect more than \$300,000 in unpaid taxes, according to Westlaw.

Pitts says Wyoming Corporate Services fully complies with the law and doesn't have any knowledge of how clients use the companies he registers. "However, we recognize that business entities (whether aged, shell or traditional) may be used for both good and ill," Pitts wrote in an email to Reuters. "WCS will always cooperate with law enforcement agencies who request information or assistance. WCS does not provide any product or service with the intent that it be used to violate the law."

THE UKRAINE CONNECTION

GERALD PITTS AND his own incorporation firms have never been sued or sanctioned, according to federal and state court records. Wyoming officials said Wyoming Corporate Services operates legally. "If they do it by cubby holes and they are really representing each person, they meet the law," said O'Brien, the deputy secretary of state.

But clients of his have run into trouble.

Among those registered at the little house

in Cheyenne are two small companies formed through Wyoming Corporate Services that sold knock-off truck parts to the U.S. Department of Defense, according to a Reuters review of two federal contracting databases and findings from an investigation by the Pentagon's Defense Logistics Agency. The owner of those firms, Atilla Kan, awaits sentencing on a 2007 conviction for wire fraud in a related matter. (For more details, see accompanying article).

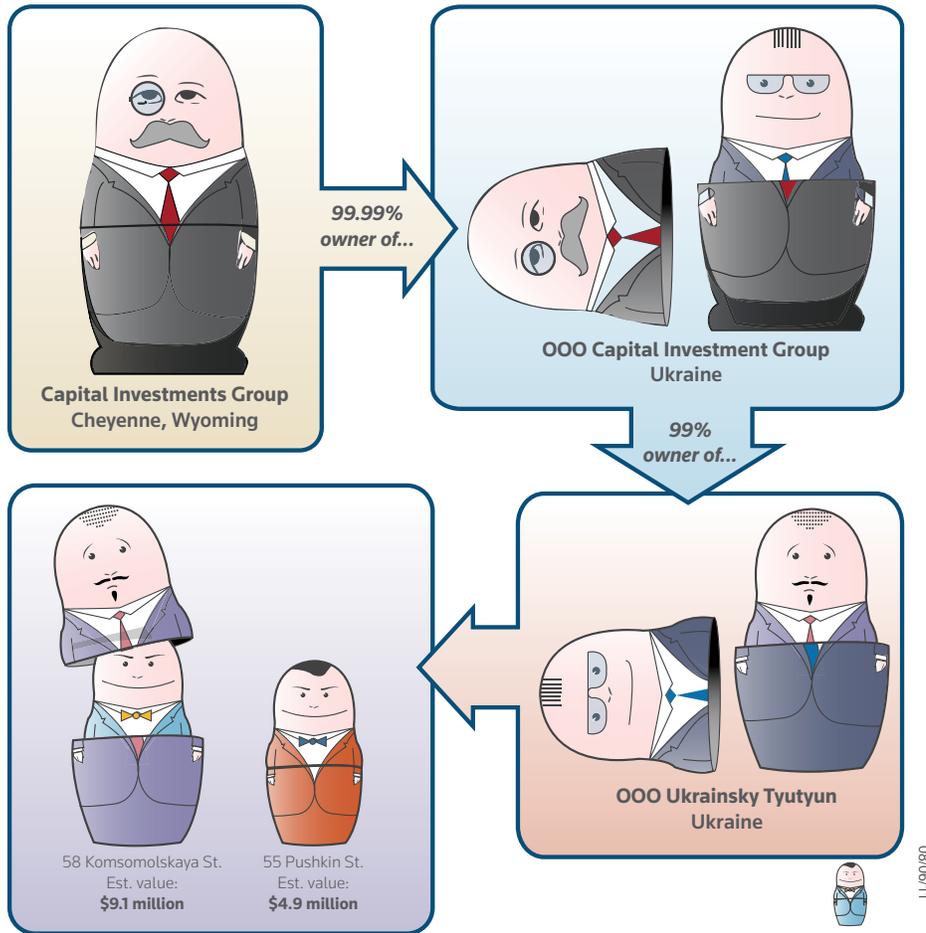
Also linked to 2710 Thomes is former Ukrainian Prime Minister Pavlo Lazarenko, who was once ranked the eighth-most corrupt official in the world by watchdog group Transparency International. He is now serving an eight-year jail term in California for a 2004 conviction on money-laundering and extortion charges. According to court records, that scheme used shell companies and offshore bank accounts to hide stolen Ukrainian government funds.

Court records submitted in Lazarenko's criminal case and documents from a separate civil lawsuit, as well as interviews with lawyers familiar with the matter, indicate Lazarenko controls a shelf company incorporated in Cheyenne that owns an estimated \$72 million in real estate in Ukraine through other companies.

The U.S. government continues to seek more than \$250 million from bank accounts in Antigua, Barbuda, Guernsey and other countries that it says were controlled by Lazarenko and his associates, according to a forfeiture action filed by the Department of Justice.

A nested network?

How Pavlo Lazarenko's alleged network of shell companies concealed valuable real estate.



Source: Court records in *U.S. v. Pavel Lazarenko and Capital Investments Group Inc. v. Victoria Korban, Gennady Korban et al*
Reuters graphic/Stephen Culp

REUTERS

The paper trail linking Lazarenko to the real estate in Ukraine is labyrinthine. At the heart of it is a shelf company called Capital Investments Group, registered at 2710 Thomes Avenue.

U.S. lawyers for a Ukrainian businessman named Gennady Korban submitted documents claiming that Lazarenko is the true owner of Capital Investments Group and other U.S. companies.

Lazarenko and Korban are rivals in Ukraine, and for years have traded allegations of corruption and assassination. An organization chart accompanying Korban's submission alleges Capital Investments Group owns 99.99 percent of a Ukrainian firm called OOO Capital Investments Group. That company, the chart claims, is the owner of another company, OOO Ukrainsky Tyutyun, where Pavlo Lazarenko is a director. Each of the firms and several others are used

as corporate fronts to control properties in Dnepropetrovsk, Ukraine, the filing alleges.

Seven properties are named in the 2009 filing by Korban, including 55 Pushkin Street and 58 Komsomolskaya Street. The dossier on Capital Investments Group claims that other directors of the alleged front companies include Lazarenko's wife, son and mother-in-law.

Federal prosecutors successfully urged the court in late 2009 to disregard Korban's submissions, arguing that it would take too much time to vet his account and thus delay his resentencing after a lengthy appeal.

A few months later, in February 2010, Capital Investments Group sued Korban and others in federal court in Delaware. That lawsuit claims two properties in the Ukraine controlled by Capital Investments Group -- 55 Pushkin Street and 58 Komsomolskaya Street -- were stolen from it using forged



BUSTED: Former Ukrainian Prime Minister Pavlo Lazarenko arrives for his trial at the federal courthouse in San Francisco, March 17, 2004. **REUTERS/LOU DEMATTEIS LD**

documents.

The lawsuit says Capital Investments was formed in September 2005. It is registered at 2710 Thomes Avenue, and Gerald Pitts, the court documents say, is "President, Secretary, Chairman and director."

But Capital Investments Group doesn't disclose the name of its owners. Daniel Horowitz and Martin Garbus, attorneys for the company, have represented Pavlo Lazarenko in other U.S. and Ukrainian litigation. They declined to provide the owners' names, citing client confidentiality, and wouldn't comment on Lazarenko's links to CIG.

The U.S. Attorney's office in San Francisco declined to comment. Asked about his association with Lazarenko and Capital Investments Group, Gerald Pitts declined to provide information on specific clients. Pitts

said he is aware of the Delaware lawsuit and "is cooperating fully with authorities in the matter."

POKER EMPIRE

ANOTHER MAN LINKED to 2710 Thomes is Ira N. Rubin. Prosecutors allege he created a Rube Goldberg-style network of shell and shelf corporations to further his scams.

In December 2006, the Federal Trade Commission sued Rubin for fraud in federal court in Tampa. Documents in the civil lawsuit allege Rubin used at least 18 different front companies to obscure his role as a credit-card processor for telemarketing scams.

These operations, the FTC alleged, offered subprime credit cards that charged an upfront fee debited from customers' bank accounts, but the cards were never delivered. The complaint also alleged Rubin processed payments for online gambling rings and pharmacy websites selling controlled substances.

One company in that network was Elite Funding Group Inc. It was registered at 2710 Thomes Avenue in August 2004 and offered for sale by Wyoming Corporate Services for \$1,095. Gerald Pitts was listed in public documents as the original director, wrote an investigator hired by the FTC in a January 2007 report filed in federal court in Tampa. Pitts had resigned six months earlier as director and was replaced by Rubin, according to court records.

Rubin's maze-like network served as the back office for alleged consumer scams operating from Canada, the Philippines, Cyprus and the U.S., with names like Freedom Pharmacy and Fun Time Bingo. His companies took consumer bank account information obtained by the clients, charged the accounts via an electronic transactions network that enables direct debits, kept a portion of the proceeds, and forwarded the rest to the alleged fraudsters, according to documents in the FTC's civil lawsuit.

To minimize scrutiny, Rubin used at least 18 different firms to handle his operations. A firm called Global Marketing Group processed payments for telemarketers offering bogus credit cards, the FTC alleged. Elite Funding, the Wyoming shelf corporation, was a subsidiary of Global Marketing. Rubin used Elite to open bank accounts with Wells Fargo Bank which held more than \$300,000 in proceeds from the payment processing, according to court records.

Just hours after Rubin was visited by a court-appointed receiver in the case in

December 2006, \$249,000 vanished from the Wells Fargo account. Rubin refused to say if he transferred the money, citing his 5th Amendment right against self-incrimination. At least \$125,000 then made its way to a bank account in Chennai, India, and has never been recovered, according to documents in the civil lawsuit.

Why use a shelf company? "To hide who they are and what they are doing. In the case of Ira Rubin, he had a payment processing empire that worked on behalf of many different industries, all of which were engaged in illegal conduct," said James Davis, an attorney with the Federal Trade Commission. "It was to his benefit to make it as difficult as possible for law enforcement to connect these companies back to him."

In 2008, Rubin fled to Costa Rica to avoid arrest for contempt in the civil case. Authorities allege he went on to run another payment-processing operation from abroad: This March 10, he and 10 others were indicted in New York for allegedly running a massive scheme to hide payments made by U.S. customers to the three largest online-poker websites, in violation of a ban passed by Congress in 2006. He was extradited from Guatemala the same month. On June 8, a New York judge denied bail for Rubin.

(<http://link.reuters.com/jud42s>)

Stuart Meissner, an attorney for Rubin, said his client was not available for comment. Pitts declined to comment.

AMERICAN LOOPHOLES

THE LOOPHOLES IN U.S. disclosure of bank-account and shell-company ownership have drawn fire.

The U.S. was declared "non-compliant" in four out of 40 categories monitored by the Financial Action Task Force, an international group fighting money laundering and terrorism finance, in a 2006 evaluation report, its most recent. Two of those ratings relate to scant information collected on the owners of corporations. The task force named Wyoming, Nevada and Delaware as secrecy havens. Only three states -- Alaska, Arizona and Montana -- require regular disclosure of corporate shareholders in some form, according to the 2009 report by the National Association of Secretaries of State.

Somelawmakerswanttighterrules.Senator Carl Levin (D-Mich.), chairman of the Senate Homeland Security Committee's Permanent Subcommittee for Investigations, has introduced the Incorporation Transparency and Law Enforcement Assistance Act each



WILD WEST: Cowboy boots painted by local artists are scattered throughout Cheyenne, a city of 60,000 residents that's become a hotbed for the business incorporation industry on April 22, 2011. **REUTERS/KELLY CARR**

year since 2008. The bill would require states to obtain and update information about the real owners of companies, and impose civil and criminal sanctions for filing false information.

"Criminals use U.S. shell companies to commit financial fraud, drug trafficking, even terrorist financing, in part because our states don't require anyone to name the owners of the companies they form," Levin said in an email to Reuters.

The bill has been beaten back by a coalition of state officials and business groups, citing concerns about the cost of implementing the new law and federal government infringement on state incorporation rights.

A leading opponent is the National Association of Secretaries of State. Kay Stimson, a spokeswoman, said in an email that the Levin bill "would have placed new burdens upon states and legitimate, law-abiding businesses—many of which are struggling to stay afloat during these difficult financial times—while continuing to provide lawbreakers with the means to evade the law."

An aide for Levin said the bill is expected to be re-introduced soon. The new bill will



FIGHTING BACK: Senator Carl Levin (right) listens at a hearing on Capitol Hill on Washington, December 3, 2010. Levin, chairman of the Senate Homeland Security Committee's Permanent Subcommittee for Investigations, has introduced a bill each year since 2008 that would require states to obtain and update information about the real owners of companies, and impose civil and criminal sanctions for filing false information. **REUTERS/HYUNGWON KANG**

add provisions requiring incorporation agents who sell shelf companies to provide beneficial owner data, said a Senate aide familiar with it.

CAT AND MOUSE

SHELL COMPANIES remain a headache for law-enforcement authorities. Officials say court-ordered subpoenas served on incorporators of shell and shelf corporations generally do deliver the names of the real owners hiding behind nominees. But if the owners are not U.S. citizens or companies, the investigation often hits a dead-end, they say.

There are additional hurdles. Wyoming Corporate Services charges \$2,500 per year to supply an attorney who can provide an extra shield. Cheyenne attorney Graham Norris Jr. tells prospective clients sent to him by WCS that he will create a company on their behalf. That way, he says, he can invoke attorney-client privilege—adding a layer of privacy anytime there is an inquiry about their identities.

“When you do need to contact Wyoming Corporate Services, you may do so through me,” advises a June 13 “Dear Client” letter supplied by Norris to Reuters. “If you contact them directly, there is a greater risk they may disclose that information in response to a subpoena; remember there is no privilege with Wyoming Corporate Services, only with your attorney.”

For a fee, clients can request that Norris file a motion to quash any subpoena, the letter says. It warns that in cases where fraud or criminal conduct is alleged, a court might order Norris to name the owners. Still, after any inquiry about identity, the letter says, Norris must inform the client—and “I must also decline to answer the inquiry.”

Investigators say they are sometimes loath to use subpoenas for the very reason highlighted in Norris’ letter—fear of tipping off targets. “In the initial stages of investigation, when we encounter a domestic shell corporation, we know we can’t subpoena the company that sold the corporation to the end users, because we don’t want the target

to find out they are being investigated,” says FTC attorney James Davis.

Other U.S. agencies raise similar complaints about shells. The 2006 U.S. Money Laundering Threat Assessment, prepared by 16 federal agencies, devotes a chapter to the ways U.S. shell companies can be attractive vehicles to hide ill-gotten funds. It includes a chart to show why money launderers might like to create shells in Wyoming, Nevada or Delaware, which offer the highest levels of corporate anonymity.

The information in the chart is credited to the Web site of a firm called Corporations Today—an incorporation service run by Gerald Pitts in Cheyenne, Wyoming.

(Reporting by Kelly Carr in Cheyenne and Brian Grow in Atlanta; additional reporting by Dan Levine in San Francisco, Jen Rogers and Jaime Hellman in Cheyenne; research by Mary Kivimaki of Westlaw; editing by Claudia Parsons and Michael Williams)

HOW TWO SHELL COMPANIES DUPED THE PENTAGON

BY BRIAN GROW AND KELLY CARR
CHEYENNE/ATLANTA, JUNE 28

TWO COMPANIES INCORPORATED at a little house in Cheyenne, Wyoming, won Pentagon contracts after their owner took advantage of the state's liberal incorporation laws to create the firms using an alias, and then represented them as minority-owned to win favorable treatment as a military supplier. The firms and their owner were later banned from doing business with the Pentagon for providing knock-off parts.

A Reuters investigation has found that more than 2,000 companies are registered at 2710 Thomes Avenue in Cheyenne, the headquarters for Wyoming Corporate Services, a business incorporation company that specializes in corporate anonymity.

Among the firms incorporated there is a small subset that make their money from government contracts.

A Reuters review of federal contracting databases found nine firms registered at 2710 Thomes Avenue have been awarded 93 contracts worth more than \$1.6 million by a half dozen government agencies, including the U.S. Department of Defense, the U.S. Treasury's Internal Revenue Service, the Centers for Disease Control, and the Department of Veterans Affairs.

More than 90 percent of the contracts were awarded by the Department of Defense.

There is no evidence that the majority of the defense-related contracts awarded to firms registered at 2710 Thomes Avenue were in any way suspicious. But two firms show the potential for the system to be abused.

In January, the Defense Logistics Agency (DLA) banned Eagle Logistic Solutions and Eagle Logistics Aerospace from selling components to the Pentagon for three years. The ban came after investigators found the



firms – and their owners – had knowingly supplied air and fluid-filtering kits for military tractor-trailers between 2001 and 2005 that were reverse-engineered in Turkey to look like they were made by Parker Hannifin, the required manufacturer.

Both firms listed their address as 2710 Thomes Avenue in Cheyenne, the DLA records show. The parts were considered “critical application items,” which the Pentagon defines as “essential to operating personnel.”

The companies were created by Atilla C. Kan, an employee of another Pentagon supplier called New York Machinery. DLA records, Wyoming incorporation data, and documents submitted by an attorney for New York Machinery in a settlement agreement in a separate federal criminal lawsuit show Kan formed the companies in Wyoming under the name John Ryan. He later used the alias, and a description of the companies as “minority-owned,” “woman-owned” and “Hispanic-owned,” when applying to supply military parts, the documents show.

A Pentagon memo detailing the proposed ban on Eagle Logistics Solutions and a sister company, Eagle Logistics Aerospace,

says the company won four contracts worth \$53,923 in which it supplied knock-off parts. But the Reuters review of the Federal Procurement Data System, a federal contracts database, shows the companies got even more business, netting orders for 44 parts contracts worth more than \$715,000.

Latonya M. Johnson, a spokeswoman for DLA, said in an email that the agency “is not currently reviewing other delivery orders filled by Eagle Logistics.”

It isn't clear whether the Pentagon screens for shell companies in the procurement process. Asked if the agency examines whether a contracting company has been registered through a third-party incorporation service and may use nominee directors and officers, Johnson said the agency “cannot speculate” on the subject.

“As long as the company has not been debarred or currently suspended from bidding on government contracts, then that company is eligible to bid on government contracts and can be awarded” them, she said.

Gerald Pitts, the president of Wyoming Corporate Services, declined to comment on specific clients.

In January 2007, Kan pleaded guilty to one count of wire fraud in New Jersey federal court as part of two criminal cases related to the scheme to supply fake parts, which included his former employer New York Machinery. The company pleaded guilty to one count of wire fraud last December.

Kan is scheduled to be sentenced in June. Kan and his lawyer, Eric Breslin, did not respond to requests for comment.

In recent years, the Department of Defense has been hit by a flood of counterfeit and non-conforming parts infiltrating its supply chain. The infiltration of fake parts stemmed largely from the Pentagon's effort since the 1990s to save money by purchasing components off the shelf.

COVER PHOTO: More than 2,000 companies are registered to this single-family home at 2710 Thomes Ave in Cheyenne, which also serves as the headquarters for an incorporation service selling aged companies on April 22, 2011. **REUTERS/KELLY CARR**

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NEVADA'S BIG BET ON SECRECY

Consultants—including some with criminal pasts—are selling the gambling center as a haven from taxes and legal liability.



REUTERS/VIJAY MATHUR

BY BRIAN GROW AND KELLY CARR
CARSON CITY, NEV., SEPT 26

ARON S. YOUNG, Wayne Andre McMiniment and Richard C. Neiswonger share two things in common.

Each man built a thriving business that helps people set up shell companies, firms with few real operations, in the state of Nevada.

And each had done time in federal prison for a financial felony.

Young served 14 months in prison for

SHELL GAMES: A Reuters Investigation

Articles in this series are exploring the extent and impact of corporate secrecy in the U.S.

employing Nevada shell companies to help clients dodge taxes. McMiniment spent three years in jail for wire fraud in a theft and tax-evasion operation that also involved Nevada shells. Neiswonger did 14 months for committing wire fraud and money-laundering in a get-rich-quick scheme.

The presence of former felons in the business of creating businesses is an

extreme example of vulnerability in corporate America. Nevada has spawned a thriving industry of consultants who aid companies seeking to avoid liability and disclosure, at a time when Washington is calling on other nations to enforce greater transparency of financial flows.

Ten years ago, Nevada enacted some of America's loosest disclosure and liability laws for corporations, in a bid to spur the state economy. It protected corporate officers and directors from liability for breaches of duty, bad faith and self-dealing

NEVADA IS ATTRACTING AN OUTSIZE NUMBER OF COMPANIES WITH SHAKY FINANCIAL REPORTING, ONE STUDY FOUND.

— acts that can be the basis of lawsuits in other states.

Today, the business of registering companies in Nevada, many of them shells, is booming.

Nevada has emerged as the state with the second-largest number of corporate entities registered per capita, after longtime leader Delaware. The state's business-filings unit generated revenue of \$108 million in fiscal 2010, up from \$43 million in 2002.

At the same time, Nevada is attracting an outside number of companies with shaky financial reporting, according to a study published in March by Michal Barzuza and David C. Smith of the University of Virginia.

On average, in each year between 2000 and 2008, 14.5 percent of public Nevada companies restated their accounting; 12.6 percent lowered reported net income; and 1.3 percent were the subject of fraud allegations or investigations by regulators, the study found. Nationally, 8.5 percent of companies restated their accounts, 7.3 percent reduced their reported net income and 0.9 percent were subject to fraud allegations or probes.

Nevada also emerged as a hotbed for a key subset of shell companies, those that are listed on stock exchanges. Financial consulting firm PrivateRaise says that 588 of the 1,215 publicly-traded U.S. shell companies it monitors, or nearly half, are registered in Nevada. Public shells have drawn scrutiny from regulators as a backdoor way for foreigners to list on U.S. markets, because buyers can get a listing without the scrutiny of an initial public offering.

In effect, says University of Virginia's Barzuza, the Silver State is marketing itself as a low-liability zone, attracting a niche of owners more prone to reporting problems.

"Nevada has all but hung up a 'no law' for-sale sign," she says.

MOST NEVADA COMPANIES are above-board. And so are most shell companies: They are used by corporations to set up side businesses under different brands, for instance. Corporations can use shells for legitimate secrecy, such as storing intellectual property that they don't want nosy competitors to know they possess.

But Nevada boosters are going a step further, touting the state as an oasis of anonymity and even impunity for business owners.

Wayne McMiniment's website claims — in a stretch of the truth, state officials say — that Nevada companies protect any individual "from personal liability for acts committed on behalf of the Corporation, by the Corporation." Aaron Young's firm pitches the state as a place to avoid the taxman's gaze: "It is very hard to pierce the veil of a Nevada corporation," its site says. Richard Neiswonger's promotional literature marketed Nevada as the alternative to an offshore tax haven: "This provides your clients with the highest level of privacy and asset protection available without leaving the country."

Nevada officials don't go so far, but they pitch the secrecy angle. "Piercing the corporate veil in Nevada requires the presence of 'fraud' or 'manifest injustice,'" says the site of the secretary of state, Ross Miller, who oversees business registrations. "This is the highest standard for personal indemnification available."

State leaders say their incorporation laws have been an economic boon, and add that the state began tightening enforcement against financial fraud as early as 2007.

"We're proud to be the home to hundreds of thousands of companies that participate in legitimate commerce and keep the nation's economy moving," Secretary of State Miller

said in an interview. "With the volume of filings we have, you have to realize that we're going to have some bad apples, and therein lies the cost." He added that some incorporation firms are falsely promoting Nevada "as a safe haven for criminal activity" and that he planned to crack down on them.

The three firms run by Young, McMiniment and Neiswonger have created or represented a total of more than 14,000 companies in Nevada. More than 3,000 of these companies have been hit with state and federal tax liens and civil judgments, or named in federal civil and criminal cases. Federal investigators alleged that these companies have been vehicles used for financial fraud, stock fraud, money laundering and tax evasion, according to court records.

Reuters detailed its discovery of former felons in the mass-incorporation industry to Nevada state officials. In response, Miller said he plans to introduce a bill barring felons from running incorporation firms. In early September, he announced the creation of a Corporate Ownership Fraud Task Force to fight abuses of Nevada incorporation rules.

"Our office is always responsive to actionable leads related to violations of our criminal statutes," said his deputy, Robert E. Walsh, in an email, "and specific information from Reuters regarding felons,



DICEY: Consultants are pitching the gambling state as a secrecy haven. REUTERS/LAS VEGAS SUN/STEVE MARCUS

mass incorporators, shells, tax evasion and fraud in Nevada certainly played a role in our realization that a more formalized multi-jurisdictional Task Force may be needed at this point."

Best known as home to the anything-goes gambling capital of Las Vegas, Nevada sought a decade ago to make it more attractive for firms to incorporate here. The bill passed because legislators saw it as a way to attract real new businesses and generate fees from people setting up companies.

Some opposed the move. "We are holding up a sign that says, 'Sleaze balls and rip-off artists welcome here,'" said Dina Titus, then a Democratic state senator, in a debate on the bill at the time. Today, she says, "a lot more harm than good has been done, to individuals as well as Nevada's reputation."

The changes bucked a trend that intensified in the U.S. early last decade, when Washington began pressing the rest of the world to clean up shady financial flows and improve corporate transparency in order to combat terrorist funding and tax evasion.

But in America itself, states with liberal incorporation laws - such as Delaware, Wyoming and Nevada - are magnets for businesses seeking secrecy.

All three states allow "nominees" to stand in for real corporate directors and officers, keeping their names out of public records and making it more difficult for law-enforcement officials, regulators and investors to identify them.

Law-enforcement officials say loose

disclosure makes it tough to investigate fraud. The U.S. Money Laundering Threat Assessment, a federal report released in 2006, named Nevada, Wyoming and Delaware as "the most accommodating jurisdictions in the United States" for the creation of shell companies, rivaling offshore secrecy havens such as the Cayman Islands and Panama. But little has been done to address those gaps.

Not everyone sees a problem in Nevada. Corporate formation is supervised by individual states in the U.S. and is largely unregulated - for the good reason that making it easy to start a business is essential to a strong economy. Nevada's incorporation regime is a welcome low-cost alternative for companies with limited capital, some scholars say.

"I don't think that the law has changed the business climate that dramatically. The laws don't blatantly allow fraud," says Larry E. Ribstein, associate dean for research at the University of Illinois College of Law.

RICHARD C. NEISWONGER HAS been sued by the Federal Trade Commission twice and sanctioned by four states a half-dozen times since the mid-1980s for falsely marketing business ventures and get-rich-quick schemes.

In 1998, he was indicted by federal prosecutors in Missouri on charges of deceptively enticing entrepreneurs to pay more than \$10,000 to become financial consultants. He pleaded guilty to wire fraud

and money laundering, was sentenced to 18 months in a Las Vegas prison and ordered to refund \$2.75 million to clients. As a condition for his release, he agreed with the Justice Department to stop using deceptive tactics to market business opportunities and potential profits.

But from 1998 to 2007, including while he was in prison, Neiswonger and two associates were able to run an operation that mass-produced shell companies, prosecutors alleged this summer.

The trio operated a company called APG Marketing and a related firm called APG Inc.; the initials stand for Asset Protection Group. The businesses were at the heart of "an asset and income concealment scheme," according to a criminal indictment filed July 5 in U.S. District Court in Nevada. They formed more than 2,800 shell companies in Nevada to help more than 1,000 clients evade U.S. taxes. Neiswonger was charged with 30 counts of mail fraud, wire fraud and money laundering.

The operation made elaborate use of shells, prosecutors alleged. One type helped clients conceal ownership of assets via Nevada shell companies. Another helped shift income to Nevada, which has no state corporate or personal income tax, to evade other state and federal taxes. A third moved clients' cash offshore through a pooled account. To hide clients' income, they opened at least 900 bank accounts with disguised corporate owners. To create false debts that could be deducted by clients from IRS tax filings, they set up 416 fake liens, the indictment alleged.

At least 69 of Neiswonger's customers evaded a total of more than \$30 million in federal taxes, the IRS alleged. One client was Nashville resident Charles Phillip Maxwell, according to documents filed by the IRS in the FTC's civil lawsuit.

Maxwell has a history of tussles with the IRS, court records show. In one of his five lawsuits against the tax agency, he claimed to be a citizen of the "Sovereign Republic Tennessee" and therefore exempt from federal taxes. He lost.

Maxwell allegedly used a Nevada shell company called Southland Investments Inc., set up by APG, to hide assets at a time when he owed \$8,394.62 in taxes. The IRS sought to collect that amount from a Bank of Nevada account held in the name of Southland. The IRS said internal records from APG showed Maxwell to be the "true account holder."

Maxwell, 60, denies any ownership in Southland. The federal judge who authorized



Secretary of State Ross Miller says Nevada is tightening oversight of "bad apples" abusing the state's incorporation laws. His website, whynevada.com, pitches the state's 'low tax climate.'

Consultants with troubled pasts

NAME	PRIOR CONVICTION/ CURRENT CHARGE	SENTENCE/FINE/ SUPERVISED RELEASE	ROLE OF SHELL COMPANIES	CURRENT/FORMER COMPANY
Aaron S. Young	Aiding and assisting filing of a false tax return	18-months/\$10,000/1-year	Enabling U.S. tax evasion	Laughlin Associates, Carson City, Nevada
Lee E. Morgan	Preparing a false tax return	18-months/\$10,000/1-year	Enabling U.S. tax evasion	Laughlin Associates, Carson City, Nevada
Richard C. Neiswonger	Wire fraud, money laundering/wire fraud, tax evasion, money laundering	18-months/\$2.75 million/3-years	Enabling U.S. tax evasion	APG Marketing/APG Inc., Las Vegas, Nevada
Wayne Andre McMiniment	Wire fraud	4-years, 4-months/\$1.9 million/3-years	Theft of client funds/ Enabling U.S. tax evasion	Nevada First Holdings, Las Vegas, Nevada

SOURCE: U.S. FEDERAL COURT RECORDS IN USA V. NEAL, USA V. NEISWONGER, USA V. REED, USA V. MCMINIMENT

the IRS to seize funds from the Southland bank account was a "common thief," Maxwell said in an interview. "There is no such thing as individual liability for income tax," he said. The IRS declined to comment.

The FTC got wind of Neiswonger's new operation and filed a civil complaint in April 2006 seeking a fine and a contempt order for violating his previous ban on deceptive marketing.

Neiswonger kept operating the APG scheme until 2007, when the state of Nevada learned of the FTC complaint and revoked the licenses of APG Marketing and APG Inc.

In July 2008, the U.S. District Court in Missouri found Neiswonger in contempt and fined him \$3.2 million. A related criminal case was filed this summer; Neiswonger pleaded not guilty. David Chesnoff, an attorney for Neiswonger, said his client was not available to comment.

The case points to a challenge authorities face in policing shell company abuses.

Publicly available court records document Neiswonger's criminal history. But no states require business-incorporation specialists to be licensed. No state bars convicted felons from forming, selling or representing companies, including people found guilty of tax evasion and other white-collar crimes. In the U.S., white-collar felons are usually deemed to have paid their debt to society and are free to remake their careers after serving their time.

WHEN AUTHORITIES TRY TO curb the business activities of people with a felony record, they sometimes face roadblocks.

In December 1998, Wayne Andre McMiniment pleaded guilty to wire fraud



Video: The business of creating businesses is booming in the Silver State
<http://link.reuters.com/geb93s>

and was sentenced to 52 months in prison and three years of supervised release, and ordered to refund \$1.9 million to clients. In addition to stealing from clients, he helped them evade taxes by creating Nevada shell companies with offshore bank accounts, according to an indictment filed in U.S. District Court in Nevada. McMiniment served three years in a Las Vegas prison.

As part of his probation, the court prohibited McMiniment from "engaging in employment, consulting or any association with any business which acts as an officer, an agent, or nominee director of any corporate entity or business during the period of supervision."

But prosecutors assert that shortly after his release, McMiniment returned to oversee operations at Nevada First Holdings, an

incorporation service headquartered a mile from the Las Vegas Strip.

In October 2003, prosecutors alleged that McMiniment may be using Nevada First Holdings "to engage in the same criminal activities for which he was convicted," and asked that the court bar him from involvement in the company, according to court records in the case. Judge Philip M. Pro of U.S. District Court in Nevada denied the request. The judge's order is sealed; it couldn't be determined why the request was turned down.

Nevada First Holding's license was revoked last year for failure to file an annual list of officers, according to the Nevada Secretary of State's office. But the company remains in business.

McMiniment confirmed in an email that



WAY OUT WEST: Laughlin Associates, an incorporation specialist in Carson City, says it has formed more than 77,000 firms since 1972. CEO Aaron Young, below, served time in prison for aiding the filing of a false tax return. His firm, he says, is 'clean as a whistle.' **REUTERS/KELLY CARR**

Nevada First still provides incorporation and mail-forwarding services. The company is promoting the sale of Nevada corporations and a sophisticated variety of shell company, known as shelf corporations, which can have years of tax filings and other records behind them.

His company has formed or represented 1,170 corporations in Nevada. Of those, 103 are still active, Nevada records show.

A number of clients have run into tax trouble. Nevada First Holdings keeps an address at 1117 Desert Lane in Las Vegas. A review of tax liens and judgments filed against companies registered there found that more than 40 have been subject to demands for payment of more than \$1.5 million from state and federal tax collectors and creditors in the past six years. The IRS filed a tax lien for \$15,835 against McMiniment last year, and four worth more than \$48,000 against Nevada First Holdings since 2008.

The IRS declined to comment.

McMiniment says he runs a legitimate consultancy. "NFH is one of the smallest incorporation companies in Nevada and it has proven to never have violated any laws in the state or its clients," he said in an email. "My personal pleading of wire fraud had nothing to do with NFH or its clients as later ruled by Judge Pro, who gave me authorization to continue to represent NFH."

The Secretary of State's office said that if Nevada First Holdings is proven to be still doing business after having its license revoked, the state may pursue civil penalties.

UNTIL ASKED ABOUT THE company's past, the Secretary of State's office was unaware of the criminal records of Aaron Young and Lee Morgan, two top executives of incorporation specialist Laughlin Associates.

According to a June 2003 indictment filed in U.S. District Court for the District of



Oregon, Young and Morgan helped dozens of people evade U.S. taxes in a scheme led by their mentor, Terry L. Neal, author of a tax-minimization handbook called "The Offshore Advantage." The trio set up domestic and offshore shell companies to hide income, and then helped clients who controlled the firms file false tax returns, the indictment alleged.

Neal, Young and Morgan provided a smorgasbord of tax-evasion services. These included "income stripping," the indictment said, in which clients billed fake companies for consulting services that later were falsely deducted as business expenses on tax returns. There were false mortgage loans and fake insurance policies, used to reduce reportable income on tax filings. Clients could park tax-evaded funds in offshore brokerage accounts or group bank accounts, and withdraw money with credit cards tied to offshore banks, the indictment alleged.

Young was indicted on seven counts of tax fraud and conspiracy for allegedly helping clients evade U.S. taxes by hiding assets behind hundreds of shell companies in Nevada and the Caribbean, according to federal court records in Oregon. Morgan was indicted on 12 counts.

"The corporations had no employees, no business premises, and conducted no business," prosecutors wrote in the indictment.

A year later, Young and Morgan each pleaded guilty to assisting or filing a false tax return. Both served 14 months in prison. Neal, the ringleader, was sentenced to six years.

Neal and Morgan did not respond to requests for comment. Young says he was a bit player in the fraud, and attributes his conviction to "naiveté."

Today, Young says, Laughlin Associates is "clean as a whistle." A number of his clients, however, have run into trouble.

Laughlin's headquarters is located at 2533 North Carson Street in Carson City. A review of tax liens and civil judgments issued in the past 10 years against companies registered at the address found that more than 230 have been the subject of demands from government agencies and other creditors for payment of more than \$13.3 million in allegedly outstanding taxes and debts. Some 120 of the liens and judgments have been issued since Young's release from prison.

Young says the companies hit with tax liens and civil judgments represent only about 2 percent of the 10,000 firms Laughlin has represented in the last 10 years.

REUTERS INSIDER



Interview: Sec. of State Ross Miller: Nevada is no "safe haven"
<http://link.reuters.com/feb93s>

The review also identified a publicly traded shell company represented by Laughlin Associates whose shares were targeted in an alleged stock-manipulation scheme.

Laughlin is the registered agent for a New Jersey-based company listed on the over-the-counter market called Euro Solar Parks, according to Nevada state records. Euro Solar describes itself as a builder and operator of solar-energy plants in Europe.

Euro Solar has the hallmarks of a shell company, with few apparent real operations. In its most recent filing with the Securities and Exchange Commission, it reported generating no revenue in the past two years and having assets of just \$16,618 as of June. A call to a phone number listed for Euro Solar's headquarters was answered by a man who said he had no affiliation with the company. The chief executive couldn't be reached.

In March, federal prosecutors in the Eastern District of New York indicted two stock promoters for attempting to illegally manipulate Euro Solar's share price. Between February and March of this year, stock promoters Joseph Catapano and Michael Piervinanzi offered an undercover government agent a 30 percent commission to buy, along with other brokers, 3 million shares of Euro Solar and hold the stock at least six months.

Catapano and Piervinanzi, without admitting or denying the allegations, were permanently barred from penny-stock transactions in July and fined an amount to be determined. The Justice Department withdrew criminal charges in September, with the right to refile them later.

Attorneys for Piervinanzi and Catapano said their clients were not available for comment.

Young said authorities hadn't contacted his firm about the case. "I have no idea what clients do with the corporations they have us form for them," he said.

The tax-evasion operation of Aaron Young and his associates drew the attention of Senate investigators back in 2006. The Senate's Permanent Subcommittee for Investigations documented their operation in detail in a report called "Tax Haven Abuses: The Enablers, The Tools and Secrecy".

Asked if Senate investigators knew Young was back in the incorporation business, a senior staff member involved in preparing the report replied in an email: "Nope ... Unbelievable."

(Additional reporting by Nanette Byrnes in Chapel Hill, North Carolina, Thomas Brown in Miami, Alexander Huebner in Frankfurt, and Jen Rogers and Ruben Ramirez in Reno and Carson City; research assistance by Mary Kivimaki of Westlaw; editing by Michael Williams and Claudia Parsons.)

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A CAUTIOUS CRACKDOWN

BY NANETTE BYRNES AND
CYNTHIA JOHNSTON
LAS VEGAS, SEPT 8

EARLY THIS MONTH, Nevada Secretary of State Ross Miller's office shut down a Las Vegas registered agent called Power Point Management and revoked the corporate status of its 427 active clients.

It was an example of how his office will "aggressively enforce our statutes and regulations," Miller said, warning that his state's 'business friendly' ethos "should not be interpreted to mean 'haven for bad actors.'"

Power Point is part of Nevada's booming industry of business incorporators and registered agents, more than 700 firms in all, whose key service is to receive on behalf of the companies they've registered any notices of litigation, tax documents and other records required by the state. Like most, it's a small operation. It has offices at the end of a winding interior hallway in a faded, stucco, two-story office park on Las Vegas' Flamingo Road. The building's rental manager, Laba Singh, says the firm sends in its "\$200-something" rent check by mail each month, but he has never seen the tenant.

The issue that got Power Point in trouble seems minor: It claimed that it, and every one of its clients, was a home-based business making under \$27,000 a year. Such businesses don't have to pay Nevada's \$200 annual licensing fee. If all 427 of Power Point's clients falsely claimed the \$200 exemption, then Nevada lost out annually on \$85,400 in total.

An analysis by Miller's office, however, points to a bigger problem. The number of such business exemptions claimed each quarter has nearly tripled since 2009. Miller has sent letters to 60,000 businesses claiming the exemption, one in five state registrants, asking for proof they fit the

home office exemption. Any that fail to comply will lose their corporate status, he says. In the office's investigation of a limited number of these businesses, there was not one instance of a proper claim.

An audit by the Nevada Executive Branch predicted the state will lose nearly \$11 million due to a sharp increase in companies falsely claiming to be exempt from licensing fees.

"We realized either we had a lot of businesses ripping the state off, or we had out-of-state companies not doing legitimate business in Nevada," Miller told Reuters in a telephone interview from his office in Carson City.

Miller's office discovered that few of Power Point's clients have any clear connection to Nevada. Most seem to be based in Taiwan, some with mainland Chinese operations.

Power Point executives reached in Taipei declined comment. The firm's website

highlights Nevada as one of several offshore locations offering "tax benefits, limited liability, profit deferral without deadline and the possibility of an IPO." But people with knowledge of the situation said Power Point's clients had been interested in setting up Nevada businesses as a stepping stone to building their brands in the U.S.. That proved difficult, these people said. Attempts by Reuters to contact many clients directly were unsuccessful.

Miller says the state is getting tough, but PowerPoint is just one of 700-plus registered agents operating in the state, and he wants to act before federal legislation proposed in August by Senator Carl Levin of Michigan, or other "burdensome" federal attempts to weed out bad actors, gets momentum. "It's clear that we have to clean up our own house before Congress tries to do it for us," Miller says.

(Nanette Byrnes reported from Chapel Hill; additional reporting by Cynthia Johnston in Las Vegas; editing by Claudia Parsons and Michael Williams)



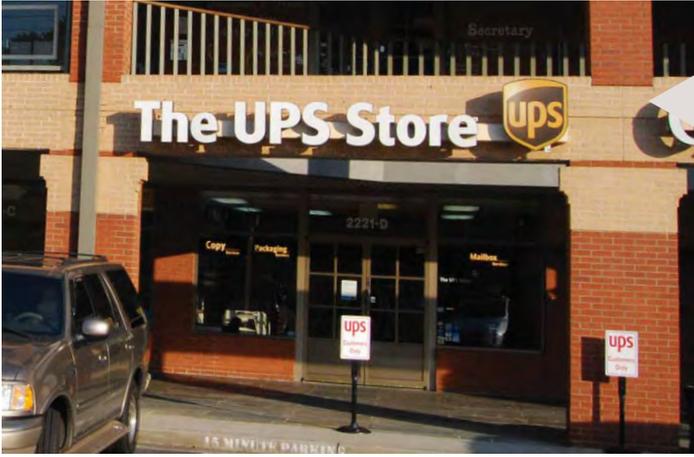
MAKING A POINT: Nevada is home to 700-plus incorporators and agents. The state closed a small firm in Las Vegas (above) after finding clients dodged registration fees. **REUTERS/LAS VEGAS SUN/STEVE MARCUS**

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An HIV/AIDS treatment center?

In Excess LLC billed Medicare for \$2.2 million.



Treatment center for Bubble Boy disease?

Gainesboro Ultimate billed Medicare for \$200,000.



An HIV/AIDS treatment center?

Strong Hope Co. billed Medicare for \$3.4 million.

SPECIAL REPORT | DECEMBER 2011

Mediscam

HOW CRIMINALS EASILY FORM FAKE COMPANIES TO SWINDLE MILLIONS FROM MEDICARE

By Brian Grow and Matthew Bigg
Miami and Atlanta

An HIV/AIDS treatment center?

More Than Ready Co. LLC billed Medicare for \$1.7 million.



SHELL GAMES A Reuters Investigation:

Articles in this series explore the extent and impact of corporate secrecy in the U.S.



An HIV/AIDS treatment center?

Medical Services of Southern Georgia billed Medicare for \$823,531.

BY THE TIME authorities busted a fake AIDS clinic in Miami, it had bilked Medicare of more than \$4.5 million. Still, the man behind the scheme remained far ahead of the agents pursuing him.

Michel De Jesus Huarte, a 40-year-old Cuban-American, hadn't simply avoided arrest. He had hatched a plan to steal millions more from Medicare by forming at least 29 other shell companies – paper-only firms with no real operations. Each time, he would keep his name out of any corporate records. Other people – some paid by Huarte, some whose identities had been stolen - would be listed in incorporation papers.

The shells functioned as a vital tool to hide the Medicare deceit – and not only for Huarte. Hundreds of others have used the veil of corporate secrecy to help steal hundreds of millions of dollars from one of the nation's largest social service programs, a Reuters investigation has found.

Huarte is now behind bars and did not respond to requests for comment. But basic checks by Reuters of Medicare providers in one city - Miami - suggest shell companies remain prime tools in perpetrating fraud. Simply by reviewing the incorporation records of Medicare providers in two buildings there, reporters uncovered information that one government official said could prompt “a serious criminal investigation” of some of the companies.

The fraud rings merge stolen doctor and patient data under the auspices of a shell company and then bill Medicare as rapidly as possible. Other shell companies are often layered on top to camouflage the fraud, law enforcement officials say.

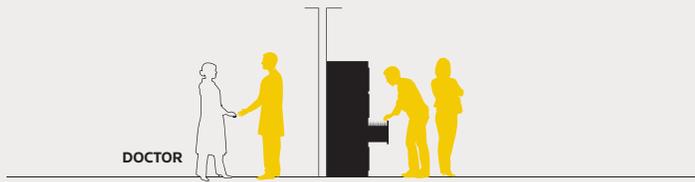
Some of the shells purport to be billing companies; they form a buffer between the sham clinics and Medicare. Others pay kickbacks to doctors and patients who sign off on bogus medical claims or sell their Medicare ID numbers to enable the shell company to bill the government. Still other shells act as fronts to launder the profits.

The key to this kind of fraud, known as a “bust-out” scheme, is for each of the fake companies to bill as much as possible before authorities catch on. Shell companies become a tool that helps keep the crooks ahead of the cops.

“This is a *Catch Me If You Can* environment,” says Ryan K. Stumphauzer, a former assistant U.S. attorney with the Department of Justice in Miami who prosecuted the Huarte case and scores of other Medicare frauds involving shell companies. “We had no clue who Huarte was. We had no idea there was some mastermind out there.”

WHEN AUTHORITIES CAUGHT UP WITH MICHEL DE JESUS HUARTE, HE HAD FORMED DOZENS OF SHELL COMPANIES AND USED THEM TO BILK MEDICARE OF TENS OF MILLIONS OF DOLLARS.

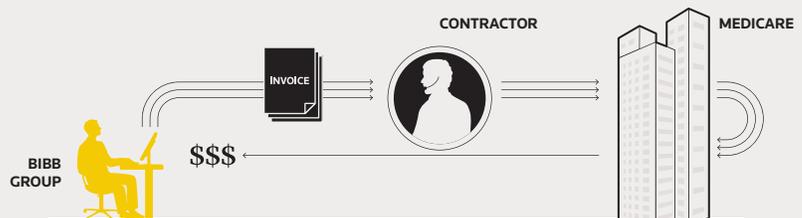
HERE'S HOW IT WORKED IN ONE CASE:



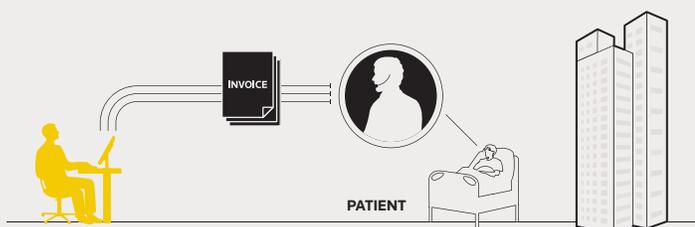
Huarte's partners conduct a fake job interview with a doctor and steal her identity, including her Medicare provider number.



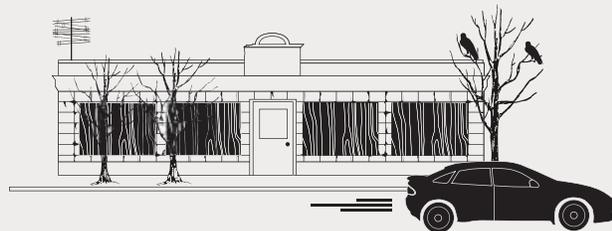
A shell company named BIBB Group Services, located in an abandoned building, adopts the doctor's Medicare provider number. The clinic purports to provide HIV and AIDS treatments.



Through a contractor, BIBB Group rapidly bills Medicare using legitimate claim codes for \$5.8 million during a seven-month period; Medicare pays \$600,000.



After a complaint from a beneficiary, a Medicare contractor flags the bills from BIBB Group as potentially fraudulent and payments are blocked.



Huarte and gang activate other shell companies such as First Choice and In Excess LLC, using new stolen identities.

Last year, “improper payments” resulted in \$48 billion in losses to the Medicare program, nearly 10 percent of the \$526 billion in payments the program made, according to a Government Accountability Office report last March. Exactly how much of those payments moved through shell companies remains unclear. That’s because neither Medicare nor law enforcement agencies systematically track how often such companies are used in the frauds. And not until 2007 did the federal government form task forces to exclusively target Medicare fraud rings.

But recent indictments issued by those task forces indicate that shell-perpetrated fraud is pervasive. Reuters examined indictments issued since 2007 in the eight states that have Medicare fraud task forces in place. The examination found that shell companies were involved in more than a third of the fraudulent Medicare claims identified by the task forces - \$1 billion of the \$2.9 billion uncovered.

The indictments and other cases indicate that at least 300 shell companies posed as legitimate Medicare providers and billing firms, or laundered payments from Medicare. Court records show shells have purported to provide services ranging from treating varicose veins to supplying prosthetic limbs.

“These companies are nameless, faceless entities collecting billions in secret,” says Patrick Burns, director of communications for the advocacy group Taxpayers Against Fraud in Washington, D.C. Medicare is “chasing it,” he says. “But they’re not getting any closer.”

THE SHELL companies bedeviling Medicare exemplify a national problem that Reuters documented in a series of stories this year. During the last decade, Washington has called on the rest of the world to clean up shady financial flows and improve corporate transparency to combat terrorism and tax evasion. Even so, U.S.-based shell companies remain a significant tool of deception – in this case, to swindle hundreds of millions of dollars from taxpayer-supported Medicare.

In one of the largest cases of Medicare fraud ever charged, the operation was enabled by shell companies. In October 2010, federal prosecutors indicted 44 members of an Armenian organized crime ring. Their network, which stretched from Los Angeles to Savannah, Ga., used 118 shell companies in 25 states to pose as Medicare providers, billing more than \$100 million, according to federal indictments in three states.

The difficulty of spotting – and stopping – shell-perpetrated Medicare fraud is compounded by incorporation laws that vary

States resist efforts

BY BRIAN GROW
ATLANTA, DEC 21

BASIC computer-assisted sleuthing can turn up shell companies involved in Medicare frauds. But U.S. government officials overseeing the program have only just begun using those techniques.

Tracking down the people behind those shells is even more difficult - and U.S. states are resisting steps that might help crack such cases.

A Reuters analysis of state incorporation records suggests that relatively simple steps can help identify fraud. Reporters scrutinized corporate filings for more than 60 purported Medicare providers in Florida, Georgia and other states. Using Google Maps, site visits and calls to officers listed in the incorporation records, Reuters identified more than two dozen fictitious addresses, a half dozen stolen identities, and changes in corporate officers or owners that federal law enforcement agents say may signal fraud.

Some 35 of the entities were part of a criminal fraud ring that has been shut down. But 26 of the entities reviewed by Reuters remain Medicare providers. Edward Pound, a spokesman for the Recovery Accountability and Transparency Board, which monitors the \$787 billion stimulus fund for possible fraud, reviewed Reuters’ data. He said the findings “could lead to criminal investigations.” The board referred Reuters’ findings to the Department of Health and Human Services’ Office of Inspector General.

In the U.S., companies are registered at the state level, with state secretaries. But few if any states are conducting the kind of basic examination of incorporation data that turned up the kinds of tips found in the Reuters analysis.

A spokesman for Florida Secretary of State Kurt S. Browning said his office conducts no checks on the validity of corporate information, including whether an address for a company is real or whether officers and directors have criminal records.

In Georgia, anyone can register a corporation for a \$50 fee. Brian Kemp, the

Georgia Secretary of State, says he has no power to spot attempts by criminals to register fraudulent companies or to weed out bogus firms. “If you fill the paperwork out and send your money in you are registered,” he says.

Even after a shell scam is detected, it can be hard to identify the criminals behind the company. In the fight against shell company-enabled Medicare fraud, two bills introduced this year in Congress would help U.S. investigators pierce the veil of corporate secrecy. But the effort is bogged down amid opposition from state regulators.



Bills introduced in August by Sen. Carl Levin (D-Mich.) and in November by Rep. Carolyn Maloney (D-N.Y.) would require states to collect the names of the real – or “beneficial” – owners of certain types of firms. States currently don’t collect such data. If they did, U.S. law enforcement officials say, it would be harder

for fraud rings to perpetrate their crimes by hiding their identities behind nominee officers and owners.

Secretaries of State and business groups have lobbied strongly against the bills. Since 2008, the Senate version has been defeated twice. State officials say the legislation would infringe on states’ rights and impose excessive costs at a time when the economy is struggling.

“Our members are particularly concerned about the significant amount of additional resources and staffing that would be needed to carry out this extra work, particularly at a time when many states are dealing with serious budget shortfalls and cutbacks,” says Kay Stimson, a spokeswoman for the National Association of Secretaries of State, a trade group that represents state regulators.

That means federal investigators chasing Medicare fraud will have to continue trawling sketchy corporate records for clues. “We almost expect that the Secretary of State data is going to be fraudulent,” says Derrick L. Jackson, special agent in charge of the southeast region for the Department of Health and Human Service’s Office of Inspector General.

(Editing by Blake Morrison and Michael Williams)

from state to state and make forming fake businesses easy. Intentionally submitting false corporate information constitutes fraud in every state. But none check the validity of corporate records when a company incorporates or collect information on the “beneficial owners” - those with a controlling interest in the corporations.

Because Huarte’s shell companies, like others, were incorporated with various state governments, the corporate documentation gave the fake clinics a veneer of legitimacy. And because Huarte was seldom listed in the incorporation papers, connecting him to the cons became more complicated. The strategy enabled the scheme to go largely undetected by authorities for years, even though most of the operations had mailing addresses that betrayed their fiction. More than a dozen corresponded to UPS stores, Reuters found. Others tracked back to shabby apartments.

For example, a purported cancer clinic called Bellemeade Oncology Care lists its address in Georgia state records as 1500 Bellemeade Dr., #4D, Marietta, Ga. But a visit to the address reveals it isn’t a clinic at all. Rather, it’s an apartment with a broken washing machine on the front stoop and a pick-up truck parked in the grass outside the complex on Atlanta’s north side.

In Florida, FBI agents say almost every Medicare fraud scheme involves shell companies. There, Reuters scrutinized incorporation documents for firms located in two buildings near the Miami International Airport. In a building with dimly lit corridors, a rickety elevator and almost no one in sight, a host of companies purport to provide services to Medicare recipients. But telltale signs of fraud abound.

Many of the 26 companies in the buildings had replaced corporate officers at least once in the last four years. Some had changed ownership, or their corporate executives represented more than one medical-related company. Law enforcement officials consider such activities to be red flags for fraud.

Reuters subsequently asked analysts from the Recovery Accountability and Transparency Board to use its software programs to examine the companies. The board monitors \$787 billion in stimulus funds for fraudulent activity using sophisticated computer systems; last year, it had worked with Medicare officials to look for patterns of fraud.

Earlier this month, board head Earl E. Devaney said the companies Reuters identified represent “a pretty big case.” Devaney, who is also the inspector general for the Department of the Interior, says the board’s analysis of the 26 Medicare providers

led investigators to another 15 Medicare entities associated with those providers. He believes the findings could prompt a “serious criminal investigation.” The Miami Medicare providers, he said, “have the distinct look of the kinds of scams we’ve seen before.” The results of the board’s analysis were sent to the inspector general of the Department of Health and Human Services for further investigation, Devaney said.

FEDERAL PROSECUTORS struggled for years to spot, let alone stop, Huarte’s shell game. They describe his operation as “remarkable for its geographic breadth, organization, sophistication, and size.” From 2005 until early 2009, Huarte and at least seven co-conspirators operated at least 35 fake Medicare clinics in Florida, Georgia, Louisiana, North Carolina and South Carolina, court records show.

During that time, his scams operated “virtually uninterrupted,” according to a

“It was like whack-a-mole for a time.”

September 2009 superceding indictment and other court records filed in U.S. District Court in Florida. They billed Medicare for more than \$100 million and received at least \$34 million in payments for non-existent HIV and AIDS treatments and varicose vein care and pain management therapy that never occurred.

The key: Huarte stayed steps ahead of

authorities by setting up new companies before the government could sniff out the fraud from his old ones, court records show. “It was like whack-a-mole for a time,” says Alanna Lavelle, a director of investigations for Medicare contractor WellPoint Inc., who chased the case against Huarte for more than a year. “It became frustrating.”

It began like this: In 2005, Huarte and his co-conspirators formed or acquired control of six medical clinics in Florida, each with its own office. Patients were then recruited and paid kickbacks to periodically appear at the clinics or allow use of their Medicare numbers, according to a plea agreement signed by Huarte in October 2009. The clinics were shams – patients weren’t receiving legitimate treatment there. Later, when authorities caught on, Huarte created shell companies consisting of entirely fictional clinics - those that corresponded with mailbox stores, for instance.

Most of the clinics purported to treat HIV and AIDS patients. Bills submitted for expensive injections of drugs such as Infiximab and Rituxan, which fight immune system deficiencies, cost Medicare as much as \$7,800 per dose, according to the indictment.

To disguise Huarte’s role, “straw owners” were paid as much as \$200,000 to put their names on Florida incorporation records and bank accounts. In return, some straw owners agreed to “flee to Cuba to avoid law enforcement detection or capture,” according to the indictment.

For instance, Madelin Machado is listed as president of Zigma Medical Care, the



A FAKE CLINIC: Alanna M. Lavelle, director of investigations for WellPoint, stands outside a UPS location in Atlanta where criminals rented a mailbox. That mailbox was the address for a phony clinic used to perpetrate Medicare fraud.

REUTERS/TAMI CHAPPELL

fake Miami clinic that collected \$4.5 million from Medicare. In January 2008, after authorities figured out the scam, Machado was indicted for healthcare fraud in Florida. She subsequently disappeared, although she's still listed as Zigma's president in state records.

Huarte's cover-ups proved successful for years, even as he secretly directed his fake companies, authorities say. He later replaced Zigma and the other Florida clinics with shell clinics in Atlanta such as New Age Family Institute and Elusive Quality, according to federal court records. Although each was registered in state incorporation records, neither the Centers for Medicare and Medicaid (CMS) nor state officials checked the validity of the corporate documents, a review that may have uncovered the fraud.

CMS, which runs Medicare, says it doesn't have the resources to analyze incorporation records for each of its 1.5 million providers and suppliers. Those records are separately maintained by each state.

Almost all of Huarte's corporate data proved a lie. The purported representative of New Age Family Institute was a deaf retiree whose identity had been stolen, an FBI affidavit said.

Medicare claims filed by each of the fake clinics were accompanied by all the right doctor, patient and treatment codes, say law enforcement officials and fraud investigators.

But New Age Family Institute was purportedly located in Atlanta at 205 South 49th St., according to state incorporation records. A Google Maps search shows that address doesn't exist. Elusive Quality's address - 925B Peachtree Street N.E., Suite 131 - was actually a UPS store in Atlanta's Midtown district.

Some of the people listed as officers in incorporation papers say they didn't know their names had been used until contacted for this article.

One, Jimmie Dominic Dancer, is an instructor at the Emory University School of Medicine in Atlanta. State incorporation records name him as the chief executive and chief financial officer of S.T.R. of Georgia, a purported HIV and AIDS clinic in Atlanta that was part of the Huarte fraud network.

Dancer says he was surprised to learn that his name was listed in state records. A specialist in internal medicine, he says he has not practiced medicine since 2002. "I've

never been a CEO or CFO," he said. "I've never heard of S.T.R. of Georgia."

FOR MUCH OF 2008, Huarte continued his use of shell companies outside of Florida. From February to December 2008, he and co-conspirators formed at least 29 new sham Medicare clinics in Georgia, North Carolina, South Carolina and Louisiana, according to state incorporation records.

Authorities say Huarte bought lists of real Medicare beneficiaries from a Medicare contractor and from employees of a company that administered benefits. Then he submitted claims in the beneficiaries' names. But instead of billing Medicare directly as he had done initially, Huarte changed his approach, court records show. He began charging Medicare Advantage Plans, a program administered by private health insurers such as WellPoint Inc. and UnitedHealthcare Group, according to the indictment and a July 2009 motion to revoke bond.

A break came in early 2008, when a Medicare beneficiary complained to WellPoint that his Medicare benefits statement was wrong. It listed him as having received HIV treatments from a Huarte sham clinic called BIBB Group Services - but he didn't have HIV and he'd never received any such care.

WellPoint fraud investigator Lavelle says her team began to review the claims and the incorporation records for other clinics in Georgia.

Reuters also reviewed records and found that BIBB Group's purported home in the central Georgia town of Warner Robins - 1000 Martha Street, Suite F - is an abandoned building behind a \$59-a-night motel.

Despite efforts to stop him, Huarte and his cohorts adapted. Using stolen patient information, they called WellPoint's customer service line. They pretended to be the patients, Lavelle says, and asked to change the patients' billing addresses to post office boxes. That way, the patients themselves wouldn't receive benefits letters and the fraud might remain undetected, she says.

For the next 15 months, WellPoint denied claims and stopped payment on checks worth \$34 million that were sent to Huarte clinics.

After BIBB Group claims were blocked, new ones flowed in from new shell clinics. They first came from First Choice Group Services, Lavelle says. When those were stopped, new bills for HIV and AIDS treatments came from Strong Hope Co., In Excess LLC and More Than Ready Co. LLC. Each of those firms was

CRACKING SHELLS

To examine how often shell companies were used in Medicare fraud schemes, Reuters obtained a list of some 300 closed criminal cases brought by federal Medicare fraud task forces in eight states since March 2007. Reuters then scrutinized federal court records using Pacer, a publicly available court docket system. Open case files for fraud rings indicted by the task forces also were examined.

The federal indictments rarely make specific reference to shell companies. So Reuters looked for descriptions of false corporate entities that posed as legitimate Medicare providers or for sham companies pretending to be billing firms. Reuters also looked for firms that paid kickbacks to doctors and patients, or that laundered stolen Medicare funds.

(Reporting by Brian Grow
and Matthew Bigg,
editing by Blake Morrison)

formed in August 2008, according to Georgia state records.

"We saw more unusually named clinics pop up," Lavelle says. "We actually thought they were playing with us."

The addresses for Strong Hope, In Excess, More Than Ready and four other shell clinics also tracked to UPS stores. They billed Medicare for \$15.1 million in false medical services and received \$4.2 million in payments, according to court records.

Huarte's four-year Medicare fraud spree was finally ended in 2009. That's when federal investigators in Florida identified co-conspirators who ran Miami check-cashing businesses that turned the Medicare checks into cash. Early that year, the check-cashers agreed to secretly wear recording devices that caught Huarte and others talking about the scam.

In October 2009, Huarte, the master of the Medicare shell game, pleaded guilty to healthcare and mail fraud. He was sentenced to 22 years in a federal prison in Pennsylvania and ordered to repay \$18.3 million. Although WellPoint had blocked millions in payments, Huarte's fake clinics outside Florida had still received more than \$12 million from almost a dozen private insurers, according to Huarte's plea agreement. In total, his fraud garnered at least \$34 million from Medicare.

At a sentencing hearing in January 2010, former prosecutor Stumphauzer told the judge why he felt Huarte deserved a lengthy

REUTERS TV

HUNTING HEALTH CARE FRAUD: Who runs the fraud rings and which cities have become hotspots?
<http://link.reuters.com/tut65s>



REUTERS/JOE SKIPPER

NO PATIENTS: Former federal prosecutor Ryan Stumphauzer helped put behind bars Michel De Jesus Huarte, the man who stole millions from Medicare by purporting to run a phony clinic in the building behind him.

prison term for his shell-driven scam.

"I think what really troubles me most is their innovation," he said, according to a court transcript. "Every time Medicare gets close, every time Medicare clamps off one path, it never occurs to them to stop stealing. They just evolve the scheme and steal some more."

CMS SAYS IT HAS been handcuffed in combating shell companies that posed as legitimate providers because it lacked the resources to extensively review their backgrounds and addresses. Less than 5 percent of all payments were subjected to audits.

That led to a system in which Medicare cut checks and asked questions later. Analysts and law enforcement officials call it "pay and chase."

Until recently, Congress offered little funding to help Medicare prevent abuses. But the healthcare reform law passed in March 2010 allocates \$350 million over the next 10 years to fight fraud in Medicare and Medicaid, its sister program for the poor. The law also imposes stiffer sentences for the scam artists.

CMS is installing new fraud-fighting computer analytics to check the backgrounds of doctors and providers to ensure, for example, that Medicare ID numbers aren't being stolen. The programs may help connect the people to the corporations they're running about 75 percent of the time, says Peter Budetti, deputy administrator and director of program integrity at CMS.

Beginning in January, the locations of providers also will be checked by "geo-spatial mapping," Budetti says.

In the aftermath of the Huarte case, CMS and private contractors launched a comparison of UPS store addresses and Medicare provider locations. Investigators visited 823 locations and found that 185 providers - 22 percent - listed a UPS store as the practice location on their Medicare enrollment application. CMS says 134 providers have had their license revoked or deactivated.

New providers also will be subject to automated enrollment screening. Their names will be checked against databases that include the federal government's banned contractor lists, state and federal criminal dockets, and state licensing records.

But how much shell-perpetrated fraud

"I think what really troubles me most is their innovation."

these steps will eliminate remains unclear. The dragnet, for instance, might prompt criminals to simply create new shell companies - entities with no prior histories that wouldn't register on any government watch list.

Nor do the steps address the fundamental loophole. Although the new screening system will have access to state incorporation records, CMS acknowledges it will still struggle to pierce the shell-company veil because states don't collect information on the real owners when corporations are formed or sold.

"We want to catch this stuff when it's at the \$30,000 level instead of the \$10 million level before anyone notices," Budetti says. "With the shell companies, these people just keep trying over and over again."

(Additional reporting by Kelly Carr; editing by Blake Morrison and Michael Williams)



REUTERS/HARRISON MCCLARY

A fraud within a fraud

BUBBLE BOY BARN: The sign now reads 'Private Property,' but in bills submitted to Medicare, this barn in Gainesboro, Tenn. was Gainesboro Ultimate, a fictitious clinic where a rare ailment called 'Bubble Boy' disease was supposedly treated.

BY BRIAN GROW
GAINESBORO, TENN., DEC 21

THE TIP THAT came to authorities in Tennessee last year seemed almost too bizarre to be true.

In August 2010, the inspector general's office of the Health and Human Services Department in Tennessee was told by a watchdog group about a Medicare provider called Gainesboro Ultimate Med Service Corp. According to federal court records, the clinic was located in the town of Gainesboro, a town between Nashville and Knoxville.

In the two months before the inspector general began investigating, Gainesboro Ultimate displayed an unusual billing pattern. It charged Medicare more than \$220,000 - and was paid at least \$50,000 - for injections of pegademase bovine. The medication is used to treat a rare ailment called Severe Combined Immunodeficiency Disease, also known as "Bubble Boy disease" because its victims must live in a sterile environment.

What made the billings especially odd was this: There were no known cases of

REUTERS TV

SHELL GAMES- THE MEDICARE SWINDLE: How criminals used a mailbox store, an apartment complex and a barn to bilk Medicare
<http://link.reuters.com/rut65s>

Bubble Boy disease among Gainesboro's 962 residents, say law enforcement and local health officials.

Investigators subsequently discovered what they believe to be a fraud within a fraud, insulated by a shell company.

The patients who allegedly received treatments for Bubble Boy disease lived in Miami, even though the bills indicated they lived in Gainesboro - at 140 Lonesome Point Lane, a half-finished house on a winding mountain road. The doctor whose Medicare provider number was used by the clinic said he had never heard of the clinic, according to federal court records.

And public records indicate that Gainesboro Ultimate was nothing more than a shell company. Registered on June 29, 2010, it listed its address at 179 Buck Branch Lane and its representative as Yennier Gonzalez. Its president was named Yennier Capote,

according to Medicare provider data. The two were the same person.

Yennier Capote Gonzalez was charged with healthcare fraud and money laundering in September 2010, according to an indictment filed in U.S. District Court in Tennessee. He has not yet entered a plea. A trial is pending. Gonzalez could not be located, and his attorney did not respond to a request for comment.

Derrick Jackson, a federal agent with the inspector general's office, was in charge of the Gonzalez investigation. He says the scheme was enabled by the theft of a real doctor's identity that enabled Gonzalez to open "a new business on paper."

In November, a Reuters reporter visited the Bubble Boy clinic at 179 Buck Branch Lane. It sits just off a narrow road that hugs the bank of the Cumberland River. The address never was a medical clinic. It's a dilapidated barn that houses a rusted bed frame, discarded computer disks and a dozen animal skulls.

A broken black mailbox rests in the weeds out front, still advertising the clinic that never was. It reads, "Gainesboro Ultimate."

(Editing by Blake Morrison)

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Aubrey McClendon Chairman and CEO of Chesapeake Energy

Clockwise from McClendon: Chip East/REUTERS, Joshua Schneyer/REUTERS, Rebecca Cook/REUTERS



The Schriers



Mildred Lutz

These Michigan land owners say they missed out on hundreds of thousands of dollars after a shell company affiliated with Chesapeake rejected their leases.

The energy baron's secret

CHESAPEAKE ENERGY USED A SHELL COMPANY TO HIDE ITS ROLE IN A MICHIGAN LEASING SPREE; NOW, SCORES OF LANDOWNERS ARE ALLEGING FRAUD.

BY JOSHUA SCHNEYER AND
BRIAN GROW
TRAVERSE CITY, MICH., DEC 28

LATE IN the summer of 2010, hundreds of farmers in northern Michigan were fuming.

All had signed leases with local brokers permitting drillers to tap natural gas and oil beneath their land. All were demanding thousands of dollars in bonuses they had been promised in exchange. But none knew

for certain whom to go after.

That's because the company rejecting their leases hadn't signed them to begin with. In fact, the company issuing the rejections wasn't much of a business at all. It was a shell company – a paper-only firm with no real operations – called Northern Michigan Exploration LLC.

One jilted land owner, Eric Boyer-Lashuay, called to complain to the broker who had handled his lease. Northern, he recalls saying, is "a shell company ... a blank door

with no one behind it."

Today, he puts it this way: "It was all a fake, all a scam."

Northern has voided hundreds of land deals, and was indeed a facade – a shell company created so that one of America's largest energy companies could conceal its role in the leasing spree, a Reuters investigation has found. Oklahoma-based Chesapeake Energy Corp., the nation's second-largest gas driller, was behind the entire operation.

Chesapeake had created one shell

company that set up another, Northern Michigan Exploration. Next, Northern hired brokers who signed leases with residents such as Boyer-Lashuay. And those brokers were under strict orders not to divulge Chesapeake's role, records reviewed by Reuters show.

In fact, the effort in Michigan was directed from the very top – by Chesapeake's CEO, Aubrey McClendon. In corporate filings that Chesapeake made public earlier this year – nine months after McClendon's agents began signing Michigan land leases – McClendon is named as the chief executive officer of Northern, the shell company that voided hundreds of those leases.

Chesapeake's effort to hide its involvement isn't illegal. To the contrary, the company's maneuvering exemplifies how U.S. corporations routinely can conceal financial and corporate transactions through the use of shell companies.

President Barack Obama has called on other nations to improve corporate transparency, but under state laws governing corporate formation in America, privately held businesses aren't required to disclose

SHELL GAMES: A Reuters Investigation
Articles in this series are exploring the extent and impact of corporate secrecy in the U.S.

the individuals or companies who really own them.

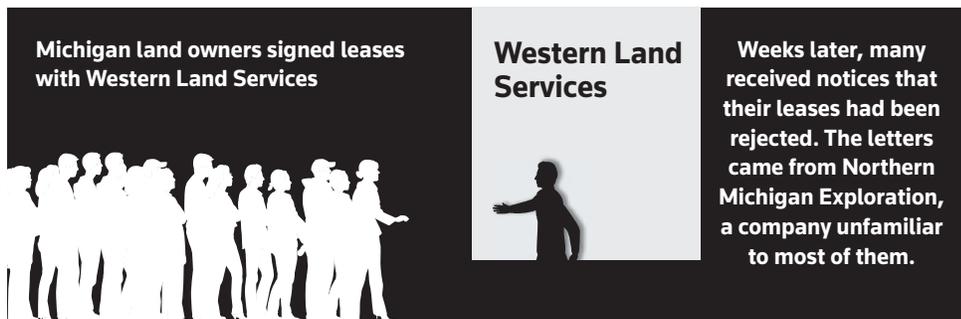
Chesapeake's own website advises land owners that their "main consideration" before leasing should be "to discover who will ultimately be producing your minerals." But Chesapeake's strategy made that extremely difficult for the Michigan land owners.

Legal scholars say the operation serves as an intriguing test case of the use of shell companies.

The tactics "raise moral and ethical questions about how entities can be used," says Joshua Fershee, a contract law professor at the University of North Dakota.

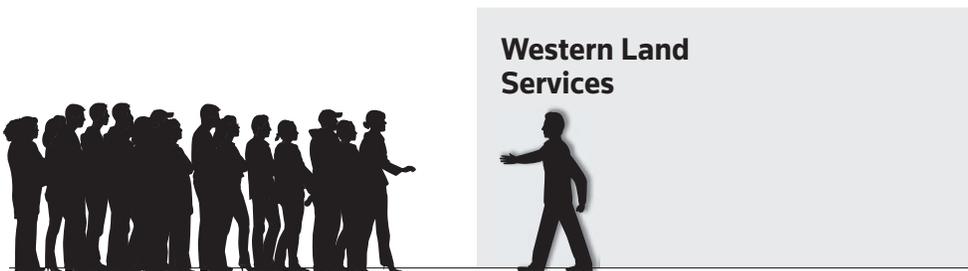
Others, including Chesapeake, defend the need to use shell companies and front companies – contractors with local ties who do business on behalf of a larger corporation. John Lowe, a professor of energy law at Southern Methodist University, calls it "business as usual."

"Shells aren't just a device to pull the wool over land owners' eyes," Lowe says. "You have to weigh some of the unfortunate cases against the fact that these companies can facilitate doing business, making it easier and probably cheaper to obtain leases. If I were a regulator, I'm not sure I'd change anything or

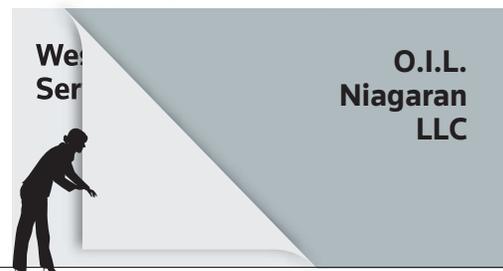


Peeling back the corporate veil

The leases held by Michigan land owners trace back to Chesapeake Energy Corp.



Western Land Services was hired as a leasing agent by **O.I.L. Niagaran**. Those leases were then cancelled by Northern Michigan Exploration.



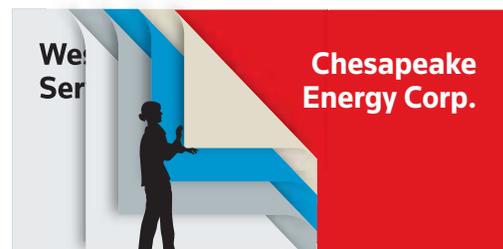
Northern Michigan Exploration is a shell company that was incorporated by LA Land Acquisition Corp.



LA Land Acquisition Corp. is a Delaware-based subsidiary of Chesapeake Energy Corp.



Chesapeake Energy Corp. is the second-largest gas and oil driller in the U.S. with \$37 billion in assets.



try to limit the use of shells.”

At least one lawmaker, Rep. Raul Grijalva, a Democrat from Arizona, says he will be “arguing for some intervention” to control the use of shell companies in such deals.

“Private property owners who enter into these transactions with good faith shouldn’t be getting duped by a front company,” says Grijalva, a member of the House Committee for Natural Resources. “It’s deception and you can’t call it anything else. It’s a good example where the intervention of government to require disclosure and binding contracts is needed.”

THE EFFORT to secure leasing rights in Michigan was part of Chesapeake’s national “land grab,” a term the company has used in its filings with the U.S. Securities and Exchange Commission.

But Chesapeake’s Michigan land rush quickly ended. In court this month, lawyers for land owners alleged that lease agreements were voided after Chesapeake learned a well it drilled in the state had come up dry.

Bonuses promised to land owners went unpaid, according to court documents submitted by lawyers for the land owners. Northern Michigan Exploration, the Chesapeake-affiliated shell company, rejected more than 97 percent of the leases its Michigan agents had signed with farmers

and other land owners, the documents allege.

More than 800 Michigan land owners – many of them elderly farmers – had their leases terminated by Northern, Reuters found.

As a consequence, owners missed opportunities to lease their land to other oil firms. At least 115 have sued, alleging that Chesapeake breached their contracts and defrauded them. On average, they each had been expecting \$95,000 in bonuses, those

“It’s deception and you can’t call it anything else.”

lawsuits show.

The near-blanket cancellation of the contracts raises the question of whether Chesapeake ever intended to pay if it failed to find oil or gas immediately, says Mark Gergen, a contract law professor at the University of California-Berkeley law school.

“It suggests they might have had a strategy going in of not honoring their agreements,” he says. “The shells would have facilitated that” because Chesapeake could blame the shells for the cancellations, suffering no damage to its reputation.

Chesapeake says it acted properly. It says some land owners were paid bonuses. It also disputes “canceling” any Michigan contracts; rather, some contracts were “rejected” because property titles didn’t pass muster, its corporate counsel says.

In written responses, Chesapeake says it sometimes uses shell companies to “keep a low profile” and avoid tipping off competitors and “speculators” about its land-leasing and drilling efforts. Such tactics are common in real estate, scholars say.

But now, Chesapeake also is using shells as a legal defense to shield itself against land-owner lawsuits. The energy giant has said in court that it was Northern Michigan Exploration, not Chesapeake, that canceled the leases.

If land owners prove that they should have been paid, at issue is who will be held accountable: Chesapeake, a corporation with \$37 billion in assets, or Northern, a shell company with no publicly documented assets.

“If Chesapeake knew from the start there was a good chance it would renege on leases and used (Northern) to avoid liability, that is improper,” says North Dakota law professor Fershee.

The burden now rests with lawyers for the land owners to prove that – to not only demonstrate that Chesapeake was directing



HOLLOW SHELL: Northern Michigan Exploration, housed here in a building two blocks from Michigan’s Capitol building in Lansing, rejected 97 percent of the leases its agents signed with farmers.

REUTERS/JOSHUA SCHNEVER

PARING BACK: EnCana, which owns this compressor station in Drumheller, Alberta, was Chesapeake's main rival in Northern Michigan.



the shell companies but also to show that Chesapeake used the shells to commit fraud.

TO UNDERSTAND the role shell companies play in Chesapeake's business, Reuters reviewed hundreds of pages of lease agreements, rejection letters and contracts, and more than a thousand pages of court records.

Reporters also interviewed more than three dozen land owners, lawyers and "landmen," those who scout for areas rich with oil and gas and strike deals with land owners.

The northern part of Michigan has a long history of smalltime drilling. But the three-month land-leasing frenzy here last year was driven by speculation that the state's Collingwood Shale area might hold large amounts of oil and natural gas.

In recent years, shale drilling has created the biggest grab for resources in the U.S. since the California Gold Rush. Thousands of so-called "shaleonaires" have grown rich by leasing their land and collecting royalties from gushers.

Chesapeake is the single biggest player in that rush, employing about 4,500 landmen. Its CEO, McClendon, started his career as an oil landman, as did former President George W. Bush.

Chesapeake says it has paid more than \$9 billion for land leases. Its holdings include about 15 million acres in at least 23 states – a drilling area nearly the size of Ireland. Since 2008, Chesapeake has raised \$13 billion by selling off a portion of those leases to energy firms as far away as China and Australia.

The business is risky. Chesapeake often slips into a shale play early, committing hundreds of millions of dollars before it

knows whether wells in the area will be gushers or dry holes.

THE COMPANY'S filings show it spent \$6.95 billion acquiring "unproved" properties last year, more than double what it spent the previous year.

Such huge spending, coupled with U.S. natural-gas prices at 27-month lows, underscores Chesapeake's aggressive financial risk profile, according to Standard & Poor's. It rates Chesapeake's corporate debt BB+, a category considered junk status.

“There are red flags when it comes to Chesapeake's transparency, convoluted ownership of shell entities and transactions shareholders can't see. ”

Some analysts balk at the difficulty of following the company's land transactions, including deals made through shell companies. The use of shells can make the moves hard to trace in financial statements.

In October, Reuters asked Chesapeake about its land-leasing in Michigan. In a written response, Chesapeake said then that it had spent about \$400 million to acquire leases there, a figure it has neither disclosed nor is required to disclose in SEC filings. Company spokesman Michael Kehs declined to answer other questions submitted this month.

Left unanswered: Whether shell companies affiliated with Chesapeake have any assets.

“There are red flags when it comes to Chesapeake's transparency, convoluted ownership of shell entities and transactions shareholders can't see,” says Phil Weiss, an

equities analyst with Argus in New York, who downgraded the firm's shares to 'sell' on Nov. 16. “I'd never know what happened in Michigan by looking at Chesapeake's filings.”

CHESAPEAKE'S LAND strategy was pieced together in part from documents that emerged in the Michigan lawsuits. Since early in the legal fight, Chesapeake has denied it conducted business in Michigan. It also denied that Northern, the shell company that voided leases en masse, was its “wholly owned subsidiary.”

For months, plaintiffs' lawyers couldn't figure out how Chesapeake could seemingly deny direct control of Northern.

The answer lies behind the corporate veil of shell companies.

Chesapeake doesn't directly own Northern; rather, Northern was incorporated by another shell company – one that Chesapeake owns and had created a year earlier. That firm, LA Land Acquisition, is the beginning of a complicated chain of shells and front companies – local contractors – operating on Chesapeake's behalf.

In April 2009, Chesapeake begat LA Land Acquisition Corp., a Delaware entity with no discernible assets.

A year later, in April 2010, LA Land formed Northern Michigan Exploration, another shell company with no known assets.

Northern subsequently hired a local land-

lease company, O.I.L. Niagaran.

O.I.L. then hired another local company, Western Land. Both O.I.L. and Western negotiated with land owners here.

The firms agreed not to disclose the energy giant's role to land owners, according to a May 2010 contract between Chesapeake and O.I.L. and other records reviewed by Reuters.

In incorporation papers filed in Michigan, Northern's address is listed as the office of a law firm in Lansing. John Pirich, a Lansing lawyer listed in state records as the representative of Northern, declined comment.

The connection between Chesapeake, LA Land and Northern appears in a Feb. 8 SEC filing, made public five months after Michigan land owners first filed suit. It shows that LA Land, which lists McClendon as a director, is the "sole member" or owner of Northern, which lists McClendon as its CEO.

Chesapeake didn't say why it used multiple intermediaries in Michigan. Lawyers say layers of shell and front companies can be used to cap liability when the companies behind the shells face lawsuits.

"The shells can complicate and delay things," says Gergen, the Berkeley law professor. "Chesapeake is probably betting that plaintiffs won't have sufficient resources or staying power to collect."

LAST YEAR, Chesapeake was competing for land in Michigan with the Canadian driller EnCana. In May 2010, EnCana announced that it had already leased 250,000 acres in the state.



REUTERS/MIKE STONE

LANDMAN: Kevin Koonce, who worked for a Chesapeake contractor, said the lease termination letters sent to landowners from Northern Michigan Exploration were a giant ruse.

Sue Brown, who owns 370 acres near Cheboygan, Mich., was bombarded with offers. "Landmen swooped in on this area like hornets out of hell," Brown says. "They'd be waiting in my driveway, completely paranoid that I was going to sign with somebody else."

That month, she and her husband were among the earliest farmers to sign a lease with a local broker working on behalf of Chesapeake. They received a \$500-per-acre bonus.

Brown's contract featured a non-disclosure clause, forbidding her from revealing her offer

to neighbors. She had no idea Chesapeake was behind it. The lease has been honored, she says.

As the frenzy intensified in June 2010, some Michigan bonuses rose to \$3,000 an acre, up 200-fold from before the boom. Chesapeake's decision to remain hidden may have been a legitimate attempt to keep prices from going even higher, some experts say.

"It's common to take leases through a shell corporation or through a landman company," says Lowe, the professor of energy law at SMU's Dedman Law School in Dallas. "If you're a farmer or a rancher and you see a big, deep-pocketed oil company pull up in your driveway, then your price goes up."

AFTER PRICES surged in Michigan, EnCana decided in July 2010 to pare back its leasing effort, a company spokesman says. According to allegations in several lawsuits against Chesapeake, CEO McClendon looked to take advantage of the opening.

He began to aggressively renegotiate or delay the completion of his own Michigan deals, the lawsuits allege.

The lawsuits by Michigan land owners also suggest a specific reason why Chesapeake's interest cooled: Through an affiliate, Chesapeake drilled an exploratory well in Michigan last July that came up dry. Chesapeake has not publicly disclosed the drilling results and declined to comment on the matter. But in the weeks after the exploratory well was drilled, Chesapeake's shell-within-a-shell - Northern - began rejecting leases en masse, letters sent to land owners show.



REUTERS/JOSHUA SCHNEIDER

FEELING FOOLED: Leslie and Sarah Schrier of Brutus, Mich., had their leases voided weeks after a landman and a notary public drove to their farm to watch them sign ahead of the deadline.

In some cases, Northern claimed that land owners missed a signing deadline, even though landmen had told them when to sign. Leslie and Sarah Schrier, a farming couple in their 80s who live near Brutus, Mich., had their lease voided weeks after a landman and a notary public drove to their farm to watch them sign ahead of the deadline, they say.

Also affected was John O'Hair, a former judge and chief county prosecutor in Detroit. He leased his 140-acre family farm in Antrim County, Mich., to O.I.L. in a contract that offered an \$84,000 signing bonus. If successful wells were drilled, the O'Hairs would receive 12.5 percent royalties.

O'Hair had leased the same land to O.I.L. a few years earlier without a hitch. This time, months passed and no bonus check arrived.

O'Hair complained to O.I.L.'s president, Dwain Provins. The response: O.I.L. was working for another firm, whose name and role were secret, O'Hair recalls. That firm had voided the lease, he was told, because one of O'Hair's in-laws appeared to own a stake in his property. Provins declined comment.

"It was a completely bogus claim," says O'Hair, 82. "I'd leased the land previously to O.I.L. with no issues."

More months passed before O'Hair learned the truth from lawyers he had hired: O.I.L. was doing the bidding of Northern and Chesapeake.

By Aug. 10, 2010, transcripts from court hearings show, at least one of Chesapeake's middlemen in Michigan seemed regretful that he had entered into business with the company.

The broker, David W. McGuire of O.I.L. Niagaran, voiced concern about Chesapeake's directives, court records indicate. He told McClendon that Chesapeake was asking O.I.L. to default on contracts that Chesapeake never intended to pay, according to the court records.

McGuire told McClendon that he had "never been put in a position like this," court records show. His comments were recounted in court this month by lawyers representing land owners.

McGuire did not respond to requests for comment on the matter.

BY MID-AUGUST, Northern began sending out rejection letters to land owners. Many were signed by the man listed as Northern's "senior landman," David W. Bolton. He also was a landman for Chesapeake itself. In an email exchange with local brokers, he used the address dave.bolton@chk.com – a Chesapeake address. He's also on a 2010 list of Chesapeake employees.



NO BONUS: Mildred Lutz, 93 years old, helps as her grandson Ryan, 32, tosses fire wood down a basement chute to store for the winter. She never received the bonus she expected to get for signing a lease on her land earlier last year.

REUTERS/REBECCA COOK

Bolton did not respond to email or phone messages requesting comment.

The lease-termination letters from Northern were a giant ruse, says Kevin Koonce, a landman who worked for a Chesapeake contractor in Michigan.

Koonce says he worked in Michigan from September to November 2010. He wasn't there to lease land. By the time he arrived, Koonce says, Chesapeake's strategy was to abandon leases it had already signed.

"Our instructions were to flunk the title if there was a word misspelled," Koonce says. He says he decided to speak publicly about the situation because he objected to the approach.

Emails reviewed by Reuters show Koonce's firm was fired in December 2010 for not signing any land owners to drilling leases in another state. He has filed an affidavit on behalf of Michigan land owners who are seeking to collect on their leases.

Koonce says his instructions to flunk leases came from a supervisor at another broker working for Chesapeake in Michigan. Koonce says he and eight other brokers participated in a conference call on Oct. 27, 2010, with the supervisor. During the call, he says, they were ordered to speed up the rate of lease cancellations.

Neither the supervisor nor the other brokers on the call responded to emails requesting comment, and Chesapeake declined to comment on Koonce or his allegations.

One land owner whose lease was rejected was Mildred Lutz, a 93-year-old widow who lives near Alanson, Mich. She says she was

told her \$97,000 bonus wouldn't be paid because her late husband didn't sign the lease and the family trust, which owned the land, is in both her name and her husband's. Never mind that the landman drafted the lease in July 2010 - a month after her husband's death.

"He knew my husband had passed away and I would be the sole owner of my property," Lutz says. Chesapeake's lawyers have said the Lutz lease had clear formatting and title flaws.

In its letters to land owners, Northern offered several reasons for voiding leases: disputes over property ownership; improper formatting of leases; and claims that properties fall outside a geographic target area.

In some cases, Northern claimed that land owners had missed a signing deadline, even though they signed leases at a time and place specified by the company's leasing agents.

In scores of other letters, Northern says leases were void because of "unsubordinated" mortgages on property. That means a property – like the approximately 70 percent of U.S. real estate that is mortgaged – isn't owned free-and-clear.

In a written statement, Chesapeake general counsel Henry Hood says a mortgage is a valid title defect "if the mortgage pre-dates the lease and is not expressly subject to and subordinate to the lease." In previous filings with the SEC, Chesapeake said it generally scrutinized titles late in the process, before drilling, and not before paying out bonuses.

Chesapeake's main competitor in Michigan,

EnCana, told Reuters that it honored the vast majority of leases it signed in the state and has faced no lawsuits that allege it reneged on any leases there.

EnCana "very rarely" voids any lease it has signed, spokesman Alan Boras says.

AS NORTHERN continued to reject leases, another company emerged in late October and went on a Michigan land-buying spree.

The hundreds of rejected leases had depressed land prices from the summertime high, and a company called Crystal Lake Resources became one of the top buyers of public land at a state

auction on Oct. 26, 2010.

The state land up for auction was also in the Collingwood Shale formation, not far from the land that Northern no longer wanted to lease from private land owners.

According to records from the Michigan Department of Natural Resources, Crystal Lake bought drilling rights on 30,000 acres for \$20.97 an acre. That's a 99 percent discount on the price promised to some land owners whose leases were canceled by Northern.

Incorporation records show Crystal Lake was formed on Oct. 25, 2010, a day before the public auction. Its Lansing address is the

same as Northern's, the Chesapeake shell company that had been canceling private leases.

In a response to one Michigan lawsuit, Crystal Lake Resources is identified as a lease buyer for Northern.

In the months since its Michigan buys, Crystal Lake has also been busy signing land leases in at least one North Dakota county.

There, in Hettinger County, clerk Sylvia Gion says Crystal Lake's leases have been assigned to one company: Chesapeake.

(Additional reporting by Jeff Jones in Calgary; editing by Blake Morrison and Michael Williams)



THE LUTZ FARM: A barn on the farm land of Mildred Lutz is seen in Alanson, Mich

REUTERS/REBECCA COOK

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