

Worst and The Frankenstein of Fraudsters



I have written about numerous scammers who used the stock market to defraud investors of their money, but one of the towering figures of this repulsive group of is Barry Minkow. I refer to him as the Frankenstein of Fraudsters because he is a con man who refuses to die, finding new kinds of fraud when he could no longer pursue his previous criminal activities. If there was a way to cheat people of their money, Barry Minkow found it.

Minkow's frauds cost investors hundreds of millions of dollars. Criminal charges against him include racketeering, securities fraud, embezzlement, money laundering, mail fraud, tax evasion, bank fraud, credit card fraud, and conspiracy to defraud the United States. Minkow is currently serving a second stint in prison, cannot be released before 2019, and has been ordered to pay over \$600 million in restitution to the people and companies he defrauded. This is, essentially, a financial life sentence. Even the most blatant of criminals has a desire to become legitimate and cover his criminal tracks, not just to avoid the criminal penalties which will inevitably occur, but because someone like Minkow wants people to accept him as a legitimate success. When Minkow ran ZZZZ Best, he spent \$2 million on commercials that only brought in \$20,000 worth of business because Minkow knew people recognized him from the

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commercials. He bought his recognition. The sad thing is that someone like Minkow can't learn from his failures. As you will see, he tried again and again to be successful, but inevitably fell back on fraud to achieve his ends, predestining his failure.

Birth of a Salesman

Barry Minkow wanted to achieve the American Dream of financial success. The “boy wonder” began pursuing his dream when he was nine years old and got a job as a telemarketer with the carpet-cleaning business his mother worked at. Six years later, he started his own business, ZZZZ Best out of his parents' garage with three employees and four phones. He became the most successful teenage businessman in the United States. Since he wasn't old enough to drive, he had to rely upon friends to transport him to different jobs. Since he was under 18, he did not have the legal right to write his own checks. Two banks closed his checking accounts before he got a local businessman to provide him with money orders and cash his checks. Minkow's business faced cash flow problems from the beginning, so he funded his business through check kiting, stealing his grandmother's jewelry, staging break-ins at his offices to commit insurance fraud, running up fraudulent credit card charges, and borrowing money from gangsters at usurious rates. Minkow found the secret to a successful business through “insurance restoration” in which he would file an insurance claim for restoration of a business from flood, fire or other damage. Minkow used insurance restoration as a cover for the money he was obtaining fraudulently. With the help of Tom Padgett, an insurance claims adjuster, he learned how to file fraudulent insurance claims to get money from banks and insurance companies. Tom Padgett was a genius at creating a paper trail of business that didn't exist. Minkow set up a fake company, Interstate Appraisal Services, which verified the details of Minkow's non-existent restorations for the banks. ZZZZ Best actually did clean carpets, but 85% of the company's revenues were from the fraudulent insurance restoration business. When ZZZZ Best had cash flow problems, the only way Minkow could raise more money was by promising to expand his business, but since the business was losing money, this only created more losses which had to be covered up with new fraudulent activities.

The American Dream Becomes a Nightmare

In 1986, shortly after graduating from high school, Minkow took ZZZZ Best public. This raised over \$11 million for ZZZZ Best after fees and costs, but even this wasn't enough to pay off all the debts Minkow had accumulated while building his business. One problem going public created was that Minkow had to provide audited accounts to comply with SEC rules. Minkow got around this by having Tom Padgett forge fake invoices, fake bank statements, fake business correspondence, and creating a paper trail that was impressive on the surface as long as no one investigated the actual activities of the company. Since the accountant who audited the ZZZZ Best's books never visited the insurance restoration sites the company owned, he never discovered they were nothing more than mail boxes. In 1986, shares issued to an officer could not be sold for two years. Once the two years were up, Minkow could sell his shares, cover his criminal tracks and achieve the American Dream of being a successful multi-millionaire entrepreneur. ZZZZ Best was like a Ponzi scheme in that the company had to continually get new investors to put money into the company to cover the debts Minkow had built up from previous investors. Minkow borrowed from Peter to pay Paul. Minkow just had to stay afloat until the two years were up, he could pay everyone off and be clear of his past. The initial public

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offering of ZZZZ Best stock raised \$15 million, making Minkow the youngest person to lead a company through an IPO in the history of Wall Street. Flush with cash, Minkow wanted to make ZZZZ Best “the General Motors of the carpet-cleaning business.” Minkow used a massive television campaign (the commercials can be found on You Tube) to expand his business across California and into Arizona and Nevada. As a result of the company’s continual expansion, by 1987, ZZZZ Best had over 1000 employees. The stock price climbed to \$18 a share, giving ZZZZ Best a capitalization of \$280 million and making Minkow worth over \$100 million. Nevertheless, ZZZZ Best still had cash flow problems since the legitimate side of the business only generated 15% of the company’s revenues. A potential solution to Minkow’s cash flow problems was to buy KeyServ, the authorized carpet cleaner for Sears, from its British parent. KeyServ’s carpet cleaning business was a cash cow and would provide a much needed cash infusion to ZZZZ Best to tide him over until the two year share restriction expired. KeyServ was twice the size of ZZZZ Best, but this didn’t stop the company from moving forward with the \$25 million purchase of KeyServ. Minkow went to Drexel Burnham Lambert to issue junk bonds to fund the acquisition. With the KeyServ acquisition, Minkow could cover his tracks, pay off his ill-begotten debts and become the CEO of a legitimate and successful business. Minkow’s ambitions didn’t end there. After absorbing KeyServe, Minkow planned to take over ServiceMaster, the leader in the industry, in a hostile takeover, and to expand into the United Kingdom. He even began discussions to buy the Seattle Mariners. Just as in a Shakespearean tragedy, with the KeyServ deal only days from being completed, Minkow’s past came back to haunt him and all his dreams of success and legitimacy collapsed. In the course of a couple weeks, Minkow went from being a multi-millionaire to being both broke and a criminal.

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Minkow faced charges of credit card fraud from numerous people, which he blamed on unscrupulous contractors, even though he knew this was a lie, and he paid off most of the claimants; however, one homemaker whom he had overcharged several hundred dollars became his undoing. That a company worth several hundred million dollars could be undone by a debt of a few hundred dollars is ironic. When Minkow ignored the homemaker's requests for repayment, she found several other people who had been cheated by Minkow. She went to the Los Angeles Times with her story, and the newspaper published an article about Minkow's credit card fraud days before the KeyServ deal was to close.

With that one story, the company collapsed because it uncovered all of Minkow's lies. ZZZZ Best's banks called in their loans, and Drexel postponed the issuance of its junk bonds to fund the takeover of KeyServ. Minkow tried to assuage investors by claiming record profits and sales, but when Ernst & Whitney discovered that Minkow had written fraudulent checks, they resigned as the company's auditors. When it was discovered the insurance restoration business was a complete fraud, ZZZZ Best was doomed. On July 2, 1987, Minkow resigned from the company. ZZZZ Best had retained an independent law firm to investigate allegations of wrongdoing. When the company asked for the addresses of the company's nonexistent restoration jobs, which Minkow could not produce, he was forced to admit the business had been a fraud. The new board of the company sued Minkow, alleging he had absconded with \$23 million in company funds, and a few days later, ZZZZ Best filed for bankruptcy under Chapter 11. Minkow and 10 other insiders of ZZZZ Best were indicted in January 1988 on 54 counts of racketeering, securities fraud, money laundering, embezzlement, mail fraud, tax evasion and bank fraud. Minkow was found guilty on all charges on December 14, 1988, and was sentenced to 25 years in prison, was placed on 5 years of probation and was ordered to pay \$26 million in restitution.

Praise the Lord, I'm Released from Prison

While preparing for his incarceration, Minkow, whose family was Jewish, became a born-again Christian, and while in prison completed his theological coursework through Liberty University's School of Lifelong Learning. Minkow was released from prison in 1995, and he became the Director of the Bible Institute and Pastor of Evangelism at the Church at Rocky Peak in Chatsworth, California. In 1997, he became pastor of the Community Bible Church in San Diego. While at the church, Minkow started the Fraud Discovery Institute which focused on finding fraud in penny stock companies. It takes a thief to catch a thief, and Minkow is alleged to have uncovered over \$1 billion in fraud from the companies he investigated. His success brought him to the attention of 60 Minutes, The Wall Street Journal, and Bloomberg News. Minkow began appearing on TV as a fraud expert. Minkow realized he could profit from his reports on other companies' frauds. Before releasing a report on the fraudulent behavior of a company, Minkow could short the stock and profit from the decline in the price of the stock that followed. Minkow was accused of "short and distort" to profit from the companies' downfalls. Small fry bring small profits. To get a large profit, you have to catch a large fish. This was Minkow's next step. Minkow revealed that Herbalife's President had inflated his resume, providing Minkow \$50,000 in profits from shorting Herbalife stock. He also received a \$300,000

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settlement with the company. Minkow's next target was the homebuilder Lennar, whom he accused of massive fraud and of being a Ponzi scheme. Talk of the pot calling the kettle black!

Short and Distort

After Minkow's accusations were made, Lennar's stock collapsed from \$11.57 to \$6.55. Minkow had been contacted by Nicholas Marsch, who had filed two lawsuits against Lennar for fraud. It turned out that not only had Minkow bought \$20,000 worth of puts on Lennar before attacking the company, but Minkow had gone long the stock after the price fell, anticipating Lennar stock would bounce back.

Accused of trying to profit from his own inside information, Minkow lied about his actions, but after the evidence presented itself, Minkow could no longer hide his deceitful activities. Florida Circuit Court Judge Gill Freeman found that Minkow had repeatedly lied under oath, destroyed or withheld evidence, concealed witnesses and deliberately tried to "cover up his misconduct." The Judge issued terminating sanctions against Minkow, in effect revoking his right to defend himself. Because of Minkow's purchase of puts on Lennar stock, he plead guilty to one count of insider trading on March 30, 2011. On July 21, 2011, Minkow was sentenced to five years in prison and was ordered to pay \$583.5 million in restitution to Lennar. As part of his pre-sentencing evaluation, Minkow was diagnosed by Dr. Michael Brannon as having antisocial personality disorder, narcissistic personality disorder, attention deficit hyperactivity disorder, anxiety disorder, opioid dependence, and anabolic steroid abuse.

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Joining Other Pastors in Prison

As a result of his criminal behavior, Minkow resigned as senior pastor of Community Bible Church. It turned out that Minkow had used church funds to fund the Fraud Discovery Institute, and he had swindled several members of his church, asking one woman for \$300,000 to fund a movie about his redemption and another for \$75,000 to fund a hospital in Sudan. Minkow admitted to embezzling over \$3 million from the church between 2001 and 2011. During those ten years, Minkow opened unauthorized bank accounts, forged signatures, diverted church money for personal use, and charged unauthorized personal expenses to church credit cards. As a result of his church-related activities, Minkow plead guilty to one count each of conspiracy to commit bank fraud, wire fraud, mail fraud and to defraud the federal government. Minkow received a sentence of five years to be served after he completed his securities fraud sentence. The earliest Minkow can be released from prison for these two crimes is June 6, 2019. After he is released, he will owe over \$600 million in restitution for the convictions relating to ZZZZ Best, Lennar and the Community Bible Church.

After Prison?

From the very beginning, Minkow ran ZZZZ Best by borrowing from Peter to pay Paul, but in the worst possible way, committing credit card fraud, borrowing at usurious rates, forging documents, kiting checks, claiming that the company was receiving huge, increasing revenues when 85% of his income was non-existent. At every step of the way, his frauds and deceits threatened to blow up in his face, and finally they did. It is amazing that in some ways, Minkow was so incredibly brilliant, and in other ways, abysmally stupid. No CEO in their right mind would pay 5% interest per week on a loan, but Minkow did. A con man always thinks he can avoid getting caught, but fraud is a house of cards that eventually collapses. Like any con man, Minkow was able to transform himself to continue conning people in new ways. In his book, Clean Sweep, like a reformed sinner, he proudly proclaimed what a crook he was. After being released from prison, Minkow became a fraud investigator who focused on undoing other people's frauds, and he became a pastor in order to lead people to God. Minkow worked with the FBI, the SEC, and police departments to uncover the frauds of others, but eventually gave into temptation and committed new frauds. Only someone who was willing to commit fraud on his level would have the audacity to use his crimes and deceits to create more fraud. Just as a lie will spin a web of bigger lies, fraud spins a web of even more fraud. What will Minkow do in five or ten years when he is finally released from prison? Will Minkow try to recreate himself as Michael Milken has done to get the respect he needs from legitimate activities? Or will Minkow follow in the steps of O.J. Simpson and once again break the law that he feels he is above? I know what my answer would be.