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Heath case shows limits of enforcing fraud laws

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By ANDREW GALVIN / The Orange County Register

As Orange County senior citizens who invested with D.W. Heath & Associates are finding out, government securities regulators don't have the investigators to tackle more than a fraction of alleged investment frauds.

Heath, which took in $178 million over 10 years from more than 1,800 people, many of them seniors, was shut down in April when its offices in Brea and Hemet were raided by federal and state authorities. The firm's principals are in the Riverside County Jail, awaiting trial on 233 felony counts.

After recovering from the shock of learning they were victims of an alleged fraud, investors began asking why Heath hadn't been put out of business years earlier.

In 1998, the California Department of Corporations ordered Heath to stop selling unregistered securities and acting as an unlicensed broker. For the next six years, Heath allegedly flouted that order and took in millions more from senior citizens, some of whom turned over their life savings.

An attorney for Daniel W. Heath, the company's president, has said his client denies any fraud. The money was invested in legitimate companies, and Heath believes that if he were allowed to continue managing his company, no investors would lose money, attorney David Bortman said.

Many of Heath's investors, however, fear their money is already lost.

(Michael Kitada / The Orange County Register)
NO NEST EGG: Gerald and Doris Davis of Anaheim say they lost their life savings when the federal government froze the accounts of D.W. Heath & Associates.

Gerald Davis, a retired Orange County business owner who invested several hundred thousand dollars with Heath, echoed others by saying: "How could the California Department of Corporations allow this to happen? Something is wrong with the system."

Answers aren't easy. There is an apparent disagreement between the state agency and the Riverside County District Attorney's Office about which had responsibility for prosecuting Heath after 2000. It appears that poor coordination between the two agencies, as well as lack of staff at both, may have allowed the Heath case to slip through the cracks.

While recently seemingly limitless government resources have been devoted to prosecuting high-profile defendants, such as Enron, Martha Stewart and Wall Street analysts, run-of-the mill scams are proliferating much faster than federal and state regulators can catch them.

Nearly 25 million Americans were victims of some type of fraud last year, the Federal Trade Commission said Thursday.

Officials at the Department of Corporations declined to discuss the specifics of the Heath case, saying they don't want to jeopardize the Riverside district attorney's criminal prosecution.

Shad Balch, a department spokesman, provided a rough timeline of the department's handling of the case. The department began investigating Heath in 1994 because of complaints from the public, he said.

In 1998, after the agency issued four "desist and refrain" orders to Heath and associated entities, department personnel met with the Riverside district attorney about the case, Balch said. The district attorney assigned a deputy and an investigator to the case, he said.

However, the statute of limitations had expired on the initial evidence amassed by the department, according to a letter sent by Deputy Commissioner Virginia Jo Dunlap to state Sen. Bob Margett, R-Diamond Bar, in response to questions raised by Margett about the case.

The department continued to investigate and formally referred the Heath matter to the district attorney in October 2000, Dunlap wrote to Margett in the letter.

A formal referral generally means a body of accrued evidence is turned over to an agency with the ability to bring criminal prosecutions, such as the District Attorney's Office.

Bill McDonald, a former chief of enforcement at the department who left the agency in 2001, said he didn't remember the Heath case. But he said that once the department referred a case of suspected fraud to a district attorney, the district attorney became responsible for enforcement.

Mark Mandio, a deputy district attorney in Riverside who is prosecuting Heath, disputed whether the department formally referred the case to his agency in 2000. He said there's nothing in the district attorney's files to indicate that such a referral was made. "I would expect to see investigative reports from investigators laying out the elements of the crime and some kind of formal request for filing" of criminal charges, he said.

It's unclear what happened to the case between 2000 and February 2004, when the department referred the matter to the U.S. Securities and Exchange Commission. Within two months of receiving the case, the SEC won federal court orders freezing Heath's assets and authorizing the raid on the firm's offices. Two months later, on June 30, the district attorney filed criminal charges against three of the firm's principals and an outside associate.

"We could not have done this without the SEC," Mandio said. "Some investigative agency had to jump-start this."

Mandio said that he wasn't pointing fingers at the department, which he said was very helpful. He added that the department had lost its entire investigative staff to budget cuts last year. "Its investigative and enforcement arm has been cut to the bone."

Experts agree the fact that the Heath case is being prosecuted at all makes it an exception.

Most alleged investment frauds never wind up in court, said Bernie Bicoy of Mission Viejo, who runs a Web site, www.vcresearch.info, that posts information about alleged frauds and charges investors a fee to access it. Bicoy, a former licensed broker, started his site after being victimized in a fraud.

The SEC annually prosecutes alleged fraud schemes worth about $5 billion, said Bicoy, who tracks such cases. He estimated that's about one-tenth of the value of frauds that are actually perpetrated.

"The only thing you can do is avoid getting into the D.W. Heaths of the world," he said. "They can't steal your money - if that's their intent - if you don't give it to them. There's no help from regulators in avoiding it and very little hope of recovery, so you're on your own."

Regulators say that investment-fraud cases are usually complex and difficult to bring, partly because it can take trained investigators weeks or months of full-time work to amass sufficient evidence. Also, investigators sometimes have trouble getting cooperation from victims of alleged scams, often because victims are more concerned with getting their own money out than helping to build a criminal case, regulators say.

In a Ponzi scheme like the one Heath allegedly ran, early investors are repaid with proceeds from later investors. This keeps early investors happy, attracts new ones and reduces the likelihood that investors will see contacting regulators as being in their interest.

Of the $178 million taken in by Heath, about $40 million was paid back to investors, according to a court-appointed receiver who has been going through the firm's records.

At a meeting of Heath investors in Hemet in June, David Brown, an attorney with the SEC, told the crowd of more than 500 that the government can't be everywhere. There aren't enough federal and state personnel to police the world of investment fraud, he said.

The SEC advises people to ask two questions before they invest:

Is the person selling me this investment registered to sell it?

Is the investment itself registered?

Research the answers independently, through the SEC or a state securities regulator such as the DOC. If the answer to either question is no, walk away.

Gerald Davis and hundreds of other Heath investors wish they had.

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