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Money Laundering Section

Criminal Division

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DOJ Prosecutions Relating to
FMS Commercial Contracts

The following is a brief summary of Department of Justice prosecutions concerning fraud against the Foreign Military Sales (FMS) Loan program arising out of commercial sales, and some observations concerning how the investigations reflect upon the program. The information being provided has previously been made public and is not protected under Rule 6(e) of the Federal Rules of Criminal Procedure. 1/

1/ This does not address pending investigations.

"AMWORLD"

The Amworld investigation began in late 1984. It involved fraud in connection with a \$28 million FMS-funded loan to the Armed Forces of the Philippines (AFP). Philippine national, Raymond M. Moreno, with the assistance of John J. Ward, a U.S. citizen now residing in the Philippines, stole at least \$3 million of the FMS loan proceeds through Moreno owned and controlled, U.S.-based, sham companies, including Amworld, Inc., which obtained FMS-financed contracts directly from the AFP. In December 1987, after a four-year investigation, Moreno and Ward entered guilty pleas in federal district court in Alexandria. Moreno and Ward pleaded guilty to conspiring to defraud the FMS program, the IRS with respect to the treatment of diverted FMS loan funds on the income tax returns of Moreno's companies, and to violate federal false statement statutes. Moreno also pleaded guilty to two substantive false statement counts. Pursuant to the plea agreements, Moreno paid \$970,000 in settlement of civil claims and tax deficiencies, and a \$30,000 fine. Ward received a suspended one-year term of incarceration. Both defendants agreed to cooperate in any further investigation of U.S. corporations that were involved in the conspiracy.

The facts on the public record relating to this conspiracy are detailed in the attached Information (Attachment 1) and Statement of Facts in Support of the Pleas (Attachment 2).

Briefly, in 1983, the government of the Philippines received an FMS loan intended, in part, to finance its master plan (nicknamed Foresight Sierra) to modernize the Philippine Armed Forces' communications system.

Shortly thereafter, three, newly-formed U.S.-based companies, Amworld, Inc., Digital Contractors, Inc., and Telecom Satellite of America, Inc., obtained FMS-funded contracts worth about \$28 million with the Philippine military to do most of the communications work required for the Foresight Sierra project. Amworld, Digital and Telecom were sham entities secretly owned and controlled by Moreno, who installed close associates, such as Ward, as titular stockholders, officers and directors. The companies had no experience with electronics or telecommunications work and were created and used for the sole purpose of obtaining FMS-financed contracts with the Philippines and diverting FMS funds into foreign accounts. None of these companies had any appreciable source of income other than the AFP-FMS contracts.

Moreno required U.S. companies, to which he awarded subcontracts with Amworld, Digital and Telecom for materials required under the Philippines-FMS contract, to double the actual price of the materials provided and to kickback the overcharges to him. The contractors paid these kickbacks in the guise of bogus marketing service payments to another Moreno owned-and-controlled company, Geomanagement, Inc., and furnished Amworld,

Digital and Telecom with inflated invoices to cover his diversions of FMS loan money from those companies' coffers.

Moreno also diverted FMS money from Amworld, Digital and Telecom by arranging for them to purchase equipment at inflated prices through other sham entities that he controlled, and by greatly overcharging them for the engineering services of his Manila-based electronics/communications companies.

Moreno stole at least \$3 million from FMS loan proceeds provided to Digital and Telecom under their FMS contracts, and he evaded federal income taxes on all of the money he fraudulently diverted from those companies and Amworld. He transferred the diverted funds, usually immediately after they were received by one of the U.S. shell entities, to foreign bank accounts he controlled through nominees in jurisdictions, such as Singapore and Hong Kong, that offer numbered accounts and have strict bank secrecy laws. Moreno maintained such foreign accounts in the names of various shell companies, relatives and other confederates. The investigation has never been able to trace the disposition of the stolen FMS money outside the United States.

"NORDAC"

This case involved fraud in connection with a 1983 FMS-funded, \$4.7 million contract between a Virginia corporation, Nordac Manufacturing Company (Nordac), and the Government of El Salvador for 19 million rounds of U.S. manufactured, automatic weapons ammunition. Nordac, which had never before dealt in

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ammunition, was owned and operated by John P. Straiton and his wife Darlene. The Straitons, and confederate John P. Fodor, illegally bribed two El Salvadoran officials to obtain the contract, delivered cheaper Yugoslavian-made ammunition instead of U.S.-made ammunition specified in the contract, and stole \$200,000 interest that accrued on advanced FMS funds. Diverted FMS funds were funneled through various foreign accounts and transferred out of the U.S. in cash.

In July 1986, the Straitons and Fodor pleaded guilty to a conspiracy to defraud and obstruct the FMS program, the State Department's administration of the Arms Export Control Act, and the IRS, to violate various federal substantive statutes, and to obstruct the government's investigation. John Straiton was sentenced to two years' imprisonment; Darlene Straiton received three-years' probation; Fodor was sentenced to pay a \$10,000 fine and to a one-year term of probation.

The facts on the public record related to this conspiracy are set out in the charge to which the defendants pleaded guilty (Attachment 3) and in the transcripts of the government's statements to the court in support of the pleas (Attachments 4&5). Briefly, in May 1983, the Government of El Salvador received a \$30 million FMS loan. Two months later, El Salvador contracted directly with Nordac for, among other things, 19 million rounds of automatic weapons ammunition. This \$4.7 million contract was to be financed with FMS loan proceeds, and thus specified that

the ammunition had to be manufactured in the United States. Nordac did not manufacture ammunition or any other equipment, and had only dealt in "soft gear," like canteens and such, before obtaining this contract.

Nordac was only able to purchase one million rounds of the requisite U.S.-made ammunition. Accordingly, the Straitons purchased 18 million rounds of the ammunition from a Yugoslav manufacturer, imported it into the United States ostensibly for domestic resale, repackaged it, and exported it to El Salvador under an export license obtained based on the Straitons' false representation to the Office of Munitions Control that it was "Winchester-New." 2/

The Department of Defense advanced the Straitons \$4.7 million for the El Salvador contract based on their false representations that all 19 million rounds of the ammunition were U.S.-made. Before the \$4.7 million was dedicated to the contract, the Straitons diverted \$200,000 interest earned on the funds. They earned an excessive "profit" on the contract, excluding the diverted interest, of about \$1.25 million because the substituted Yugoslav ammunition was less expensive than U.S. ammunition..

2/ A report of the Senate Appropriations Committee dated September 16, 1986, stated that Nordac's FMS-financed sale of inferior Yugoslav ammunition to El Salvador was tantamount to treason.

The Straitons, using various surreptitious devices, transferred \$635,363 to co-conspirator Fodor for his role in the scheme. Fodor used roughly \$400,000 of the money to bribe Salvadorian military official Colonel Jorge Rivera, who was instrumental in Nordac's obtaining the contract, and he retained the rest. Fodor's wife was related to Colonel Rivera, who received the bulk of the bribe. The bribes were paid into various foreign bank accounts controlled by Rivera or his relatives. Other diverted FMS funds were funneled through a shell El Salvadoran entity controlled by Fodor and/or were used to pay personal expenses of participants in the scheme.

After the U.S. investigation commenced in 1984, the defendants concocted a bogus building contract between Nordac and a Fodor company in El Salvador to conceal the illegal "commissions," and they submitted the sham contract to the grand jury. Fictitious invoices and other records were fabricated through Fodor's intermediary company in order to cover-up FMS diversions. 3/

"EATSCO" and related cases, Systems
Services International, and Air
Freight International

The EATSCO and related investigations began in late 1982. They involved the diversion of approximately \$8 million in the form of inflated shipping costs on a multi-million dollar shipping contract arising out of a \$1.5 billion FMS loan to Egypt. The inflated shipping costs were fabricated with the

3/ The Department of State made unprecedented reports to the Congress (Attachment 9) concerning the Nordac fraud against the FMS program.

help of an intermediary company controlled by the conspirators. The facts on the public record are detailed in the attached pleadings (Attachments 6 through 8). In summary, in 1979, shortly after Congress had appropriated \$1.5 billion to guarantee a loan to Egypt, Hussein K.E.I. Salem and Thomas C. Clines established essentially a shell company, the Egyptian American Transport and Services Corporation (EATSCO), as a joint venture of their respective companies, TERSAM USA and Systems Services International, Inc. Salem served as President of EATSCO and Clines as Vice-President and Director. A short time later, after \$1.5 billion of FMS loan funds were committed to Egypt, that country designated EATSCO as its agent to procure materials purchased with the FMS loan funds. Since EATSCO itself was essentially a sham with no legitimate capability to produce, procure, or ship anything, it, in turn, contracted with R.G. Hobelman Company, a freight forwarder in Baltimore, Maryland, to ship the defense items to Egypt. Shipments on American flag vessels could be paid with FMS funds.

Salem, Clines, and Rolf Graage, President of R.G. Hobelman, thereupon executed their scheme to divert FMS funds to themselves in the guise of inflated shipping costs fabricated by an intermediary company. In particular, the conspirators arranged for Air Freight International (AFI)--a wholly owned subsidiary of R.G. Hobelman--to perform certain freight forwarding services for EATSCO and R.G. Hobelman in connection with Egyptian FMS-financed

materials. AFI provided inflated invoices to R.G. Hobelman which incorporated the inflated costs into its own invoices submitted to EATSCO and ultimately to the Defense Security Assistance Agency (DSAA) for payment with FMS funds.

From about November 1979 through December 1981, there were 34 shipments on which false shipping (freight, packaging and consolidation) invoices were submitted. Those invoices included inflated costs of approximately \$8 million. Through this device, Salem and Clines diverted about \$5.5 million to themselves through EATSCO, and Graage pocketed about \$2.5 million through AFI. The majority of the diverted FMS funds was promptly transferred into foreign bank accounts in jurisdictions with strict bank secrecy laws. This rendered it practically impossible to trace the disposition of the stolen money.

The dispositions arising from this criminal activity were as follows:

In July 1983, in U.S. District Court in Alexandria, Salem and EATSCO pleaded guilty to conspiracy and one false statement count. The defendants paid fines totalling \$40,000 and reimbursed the United States \$3,020,000 in settlement of all civil claims.

In September 1983, AFI entered a guilty plea in Alexandria to one false statement count. The company was fined \$10,000 and reimbursed the United States \$924,000 in settlement of all civil claims.

In January 1984, SSI, through Thomas Clines, pleaded guilty to one false statement count. SSI was fined \$10,000 and agreed to pay the United States \$100,000 in settlement of all civil claims.

OBSERVATIONS

Although these cases obviously involved vastly different facts, they share certain troubling characteristics. The Amworld and EATSCO cases, for example, clearly show that companies used for looting FMS loan funds were created contemporaneously with the FMS loan agreement and for the very purpose of diverting FMS funds. Moreover, the companies used to rip-off FMS funds--such as Amworld, Digital, Telecom, and EATSCO--were essentially shell entities with no track record, no real capabilities, and no sources of income other than the FMS contracts. Nordac had never handled ammunition, or similar items, prior to the El Salvadoran contract.

Further, the fact that these type of companies are awarded FMS contracts by the loan recipient states, suggests the complicity of foreign officials. In Nordac there was no question of the involvement of El Salvadoran officials. In the other cases the funneling of diverted FMS funds through foreign accounts prevented us from identifying all the individuals who may have shared them.

In addition, in every one of the above cases the investigations were substantially impeded by our inability to obtain evidence located abroad, particularly in the loan

recipient state. In Amworld, for example, notwithstanding the mutual legal assistance agreement between the U.S. and the Philippines, three trips there by the DOJ investigative team, accompanied twice by high-level DOJ officials, produced little usable evidence. The legal assistance agreement turned out to be a one-way street. In fact, in the Amworld case, the Philippines provided little cooperation, let alone evidence. Likewise, although the El Salvadoran Government cooperated in our investigation, the difficulties encountered in conducting our investigation on foreign soil strained our investigative resources to the limit.

We also confronted almost insurmountable problems in obtaining foreign bank records to trace the ultimate disposition of diverted FMS funds. As outlined, stolen FMS funds were typically transferred out of the U.S. as soon as one of the sham U.S. entities got its hands on the money. Complicating the matter, the stolen money was routinely transferred to nominee accounts in jurisdictions, such as Singapore and Hong Kong, with strict bank secrecy laws. For example, in Amworld diverted FMS money was transferred between nominee foreign accounts.

Our letters rogatory requests to Hong Kong in Amworld, for example, took years to adjudicate and essentially produced only documents already in our possession and specifically identified in our requests. Bank secrecy laws in the havens for criminal

loot used by the Amworld and EATSCO conspirators rendered grand jury subpoenas to U.S. intermediary banks an impotent weapon. 2/

The involvement of foreign nationals--who would be unavailable to our courts even under extradition treaties--as principals in FMS fraud is another recurring problem. In Amworld and EASTCO, for example, the principal miscreants, Ray Moreno, a Philippine national and resident, and Hussein Salem, an Egyptian national and resident, were essentially immune from U.S. process. Accordingly, the prosecutors were confronted with the Hobson's Choice of obtaining a guilty plea, but agreeing to no jail, and recovering some money, or returning a toothless indictment and probably recovering none of the stolen money. In fact, to get the foreign nationals to enter the U.S. and plead was extraordinary.

Largely because of the foregoing circumstances, the United States did not recover the full amount of the stolen FMS funds in any of the cases. In Amworld, we came up at least \$2 million short; in EATSCO, we recovered about two-thirds of the diverted \$8 million; in Nordac, our recovery was essentially zero. Further, except in Nordac, none of the individual defendants received any jail time.

2/ See, e.g., In re Sealed Case, 825 F.2d 494 (D.C. Cir. 1987) (explaining constraints on U.S. courts in enforcing grand jury subpoenas for foreign bank records, and stating that "Congress could empower courts to issue contempt orders" to compel compliance with such subpoenas. Id. at 497-499. Attachment 10.

In our view, the single most important lesson that these cases teach is that allowing FMS loan recipient states to enter into direct commercial FMS-financed contracts is an invitation to larceny and bribery. Such direct commercial contracts strip the U.S. of meaningful control of the quality and cost-effectiveness of the defense items purchased, virtually ensure that any FMS funds taken by fraud will never be fully recovered, and provide foreign nationals and others with an opportunity to steal U.S. money without having to directly pilfer from U.S. coffers.

officials of the Salvadoran government, Col. Jorge Rivera, Chief of Finance, Ministry of Defense, and Col. Elmer Gonzalez Araujo, Chairman of the Ministry of Defense Buying Commission.

— The victims of this conspiracy are the governments and people of the United States of America and the Republic of El Salvador.

The Straitons made a \$1,236,683 profit on the ammunition part of the contract. They also converted \$200,000 in interest monies accruing to the \$4.7 million contract advance that DOD permitted Straiton to deposit in Nordac's bank account. They intended to pay Fodor \$500,000 but only paid \$235,762 in commissions and bribes because the investigation cut short their scheme.

Recommendation

For violating 18 U.S.C. §371 the defendants each face a maximum term of five years imprisonment and/or a fine of \$10,000. The defendants also may be ordered to pay restitution (18 U.S.C. §3579) in the amounts of \$435,762 (John and Darlene Straiton) ^{1/} and \$235,762 (John Fodor).

The restitution figures were arrived at as follows:

\$235,762 represents the Department of Defense Foreign Military Sales money illegally paid to John Fodor and Col. Rivera on the July 1983 ammunition contract and an unknown amount to Col. Gonzalez Araujo.

\$200,000 represents the amount of interest converted by the Straitons.

^{1/} The figure set forth for John Straiton in his plea agreement was \$490,814. That was corrected by the United States at the plea of Darlene Straiton. They should both be the same.

Based upon the facts of this case, the interference with the foreign policy of the United States, the undermining of the Salvadoran Army's ability to defend Salvador against communist-led guerilla forces, the large monetary loss and the lack of remorse shown by the defendants, discussed infra, the United States recommends that the Court impose a substantial period of incarceration and a \$10,000 fine on John P. Fodor and order restitution to the United States Department of Defense in the amount of \$235,762. 2/

The government recommends a slightly shorter period of incarceration for John Straiton because he was the first defendant to agree to a plea and the only one to explain his role in the conspiracy. 3/ Nonetheless, his period of incarceration should be substantial because he was entrusted by two governments with a great deal of money and entrusted by El Salvador with the safety of its soldiers. When Straiton learned that the ammunition he was providing was defective and would cause guns to jam, he hid that fact from the Salvadorans. While the United States cannot prove that soldiers died as a result of his providing 14 million rounds of defective 5.56mm ammunition, it is a fair inference that some died or were wounded. Even if no soldier died, John Straiton's

2/ The United States Department of Defense is clearly the financial victim in this case. See United States v. Dudley, 739 F.2d 175, 177 (4th Cir. 1984); United States v. Tyler, 767 F.2d 1350 (9th Cir. 1985); United States v. Fountain, 768 F.2d 790, 802 (9th Cir. 1985).

3/ We believe his explanation was not complete.

reckless endangerment of their lives demands exemplary punishment. Straiton should also be fined \$10,000. Restitution in the amount of \$435,762 should be ordered. 4/

— Because Darlene Straiton left the conspiracy prior to the obstruction attempt, the United States recommends that she receive a slightly shorter period of incarceration^{5/} than for Fodor or John Straiton. Darlene Straiton was a knowing and willful participant in this conspiracy. She traveled to Yugoslavia and she participated in the bribe payments. Thus, the United States recommends a slightly shorter period of incarceration than for John Straiton, a \$10,000 fine, and restitution in the amount of \$435,762.

Darlene Straiton would have this Court believe that she is a loving wife who unwittingly followed the instructions of her husband. This is not true. Darlene Straiton is a smart, calculating, manipulative and vindictive woman who committed the crimes in this case knowing full well the consequences of each of her acts. She was clearly one of the key players in the conspiracy. As Vice President of Nordac, she was up to her neck in the entire scheme. 5/

4/ Our purpose in asking for restitution in the full amount of \$435,762 from John and Darlene Straiton is to assure that DOD recovers whatever it can from each defendant. DOD's total recovery could not exceed \$435,762.

5/ Darlene Straiton's duplicitous, calculating character is illustrated by her conduct during the course of her divorce proceedings, which are a matter of public record. The government has submitted pages 74-81 of her publicly filed April 16, 1984 deposition in Circuit Court to the probation office.

Significance of this Case

In fiscal year 1983, thirty-three countries received DOD Foreign Military Sales Loans which totaled \$5.1 billion. This is a very important program. 22 USC 2751 states in part:

As declared by the congress in the Arms Control and Disarmament Act, an ultimate goal of the United States continues to be a world free from the scourge of war and the danger and burdens of armaments; Because of the growing cost and complexity of defense equipment, it is increasingly difficult and uneconomic for any country, particularly a developing country, to fill all of its legitimate defense requirements from its own design and production base. The need for international defense cooperation among the United States and those friendly countries to which it is allied by mutual defense treaties is especially important, since the effectiveness of their armed forces to act in concert to deter or defeat aggression is directly related to the operational compatability of their defense equipment.

Accordingly, it remains the policy of the United States to facilitate the common defense by entering into international arrangements with friendly countries which further the objective of applying agreed resources of each country to . . . achieve specific national defense requirements and objectives of mutual concern.

It is the sense of the Congress that all such sales be approved only when they are consistent with the foreign policy interests of the United States . . .

The defendants have made a mockery of the Foreign Military Sales Program. Nordac's contract price to El Salvador was \$3,624,000. By illegally purchasing the bullets from Yugoslavia, they were able to obtain an unreasonable \$1,436,683 in profit on the contract. What did this scheme leave the Salvadorans with?

All of the \$30 million in FMS money made available to El Salvador in 1983 had already been committed, so that when the conspiracy was uncovered there were no funds available to replace the defective ammunition provided by Nordac. In an ironical twist, Nordac had secretly signed a contract with a communist country to provide a United States ally with bullets to shoot at communist insurgents.

The importance of the \$30 million loan made to the Government of El Salvador on May 17, 1983, which was used by the defendants in this case to supply defective ammunition to the armed forces of El Salvador, is not apparent from the loan agreement itself but must be considered in the context of the political debate which preceded it.

President Reagan twice appeared on national television to appeal for support of his proposal to provide increased military aid to El Salvador in the spring of 1983: first on March 10th in a speech at the annual meeting of the National Association of Manufacturers, and again on April 27th in an unusual address to a joint session of Congress. In response to specific congressional demands for the appointment of a special Central America "peace negotiator," the President appointed former Senator Richard Stone on April 28, 1983, as his Ambassador-at-large for Central America. The Secretary of State responded to other congressional demands concerning the freeing of political prisoners in El Salvador and the opening of Salvadoran prisons and detention centers to inspections by the International Red Cross. The Chairman of the crucial House Appropriations Subcommittee on Foreign Operations,

Rep. Clarence D. Long, traveled on April 23-25, 1983 to El Salvador to see for himself whether further military aid was appropriate. Notwithstanding this concerted Administration effort during the spring of 1983, the Congress approved by the narrowest of margins only half of the amount of military aid requested for El Salvador.

The President set out a five-point plan of assistance and support for Central America on March 10, 1983:

First, we will bridge the existing gap in military assistance. Our projections of the amount of military assistance needed for El Salvador have remained relatively stable over the past 2 years. However, the continuing resolution budget procedure in Congress last December led to a level of U.S. security assistance for El Salvador in 1983 below what we requested, below that provided in 1982, and below that requested for 1984. I'm proposing that \$60 million of the moneys already appropriated for our worldwide military assistance programs be immediately reallocated to El Salvador.

Further, to build the kind of disciplined, skilled army that can take and hold the initiative while respecting the rights of its people, I will be amending my supplemental that is currently before the Congress to reallocate \$50 million to El Salvador.
(Weekly Compilation of Presidential Documents, Vol. 19, no. 10, p. 380)

Simultaneously with the President's National Association of Manufacturers speech, the Director of the Defense Security Assistance Agency (DSAA) released to the four appropriate congressional committees the formal notification in which the Executive Branch proposed to increase the total amount of loans to El Salvador by \$60 million as a reprogramming action. The Office of Management and Budget requested an additional \$50 million in

military grants to that country. As noted above, only \$30 million in additional loans was provided by the Congress and the Supplemental Appropriation Act of 1983 (Pub. L. 98-63, approved on July 29, 1983) contained only \$25 million in military grants for El Salvador.

The formal reprogramming notification to the Congress that the DSAA Director signed on March 10, 1983, contained the following "reprogramming justification" in pertinent part:

Approximately \$35 million will be used to fund critically short items needed by the El Salvadoran Armed Forces to conduct combat operations. Ammunition -- with reserves at or below emergency levels -- will be the first priority. Mobility and communications improvements will be emphasized by funding of wheeled vehicles and upgrade of communications facilities. Equipment and weapons for the projected additions to the El Salvadoran Armed Forces are also needed immediately, as is an uninterrupted flow of consumable supplies vital to continuation of the E Salvadoran Armed Forces war effort. (emphasis added.)

It is more than ironic that, after all the effort made by the President to secure additional funds in 1983 to sustain Salvadoran ammunition requirements, those funds were then used to pay illegal commissions, to bribe Salvadoran military officials and to finance the defendants' contract for Yugoslavian ammunition that caused Salvadoran rifles to jam in combat. 6/

Respectfully submitted,

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6/ An extract from the Congressional Quarterly Almanac - 1983 is attached as Tab D. It provides a brief review of congressional actions during that year.

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