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Characterizing Victims of Ponzi Schemes as Greedy Hurts Our Civil Justice System

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Michael S. Budwick

At a recent well-known international conference on financial frauds attended by top professionals from major insolvency firms throughout the United States, Europe and the Caribbean, a timeless question came up: “Why do investors become victims of Ponzi schemes?” The audience members, including attorneys, accountants, consultants and federal regulators, chuckled and nodded at the answer a panelist provided: “Investor greed.” My experience, however, has proved this answer is wrong, borne out of ignorance and a disservice to victims of financial crimes, law enforcement and others seeking to right the wrongs of fraudsters.

The erroneous view that “greed” is the basis for investor losses has real-life consequences. Bankruptcy trustees may seek or threaten to seek to “claw back” return of principal, challenging the investor’s “good faith.” These trustees contend that while the investor was innocent of any wrongdoing and ignorant of the fraud, the investor was blinded by greed and should have conducted a higher level of commercially reasonable due diligence before investing (i.e., the investor should have “known better”). And those that aid and abet the fraud will defend against civil liability by claiming the victim did not reasonably rely on the fraudster’s misrepresentations.

First and foremost, investors in Ponzi schemes are crime victims. They are no more to blame for their victimization than a victim of an armed robbery. And they are no more to blame for their losses than the equity investors who saw $60 billion in market value in Enron stock evaporate, more than all the losses in the Bernard Madoff Ponzi scheme, the largest in U.S. history. Equity investors in WorldCom lost $3.8 billion, more than the losses in the Thomas Petters Ponzi scheme, the third-largest in U.S. history.

There is nothing immoral or socially undesirable for an individual investor to seek a

strong return for her hard-earned dollars. The average annual return for the S&P 500 index since its inception in 1926 through 2018 is approximately 10%. Since 1980, eight times the annual return on the S&P 500 exceeded 30%. In 1954, the S&P 500 returned 52%. Were investors in equity securities in those years who sought a return beyond the rate of inflation "greedy?" Are victims of Ponzi schemes "greedier" than investors who bought Uber following its IPO, trade options, bought Amazon stock in 2015 or purchase commercial real estate? And is their supposed "greed" the reason for their financial losses, particularly where a lifetime of earnings has been lost?

Second, blaming the victim (for being greedy or otherwise) is akin to classic hindsight bias. While the mega scheme attracts media attention, Ponzi schemes of all sizes are rampant in our society. Since 2010 (post-Madoff), the SEC and the CFTC have brought hundreds of enforcement actions related to alleged Ponzi schemes. Were all those victims greedy? Steve Bowden, the son of Bobby Bowden, the former FSU coach, ran a Ponzi scheme and Bobby lost $1.6 million. As a double-Gator, I may have any number of criticisms of Bobby Bowden, but was he greedy? Joe DiMaggio was a victim of the Premium Sales Ponzi scheme. Was the iconic Yankee Clipper greedy?

Perpetrators of Ponzi schemes rely on trust. That trust can be secured in many ways, often through a common relationship or background. It may be the same church or synagogue or the same ethnic community. It could relate to having attended the same college or being a fan of the same sports team (such as Nevin Shapiro and the University of Miami Hurricanes). Members of a community will have a greater tendency to trust each other and believe that they are being offered a special opportunity that others outside their community are not.

I have represented receivers, trustees and victims in some of the largest Ponzi schemes in America. I have interviewed and deposed perpetrators, fundraisers, innocent employees, deceived professionals and victims at every level of sophistication. I often hear people say that the perpetrator could have been successful if only he had used his talents for good. He is intelligent, charismatic and great at sales. But typically, the perpetrators failed or were mediocre in legitimate business. Scott Rothstein was (maybe) an average lawyer. Bernie Madoff was not a successful trader. Tom Petters had filed for personal bankruptcy. Their true skill set is the ability to deceive and manipulate. They understand (often instinctively) human psychology. Petters' right-hand person described him as a "chameleon" who knew

what to say to all sorts of different people from political figures and hedge fund managers to Evangelical leaders. When I first met Petters at Leavenworth Penitentiary, the lifelong Minnesotan invoked Yiddish! Fraudster Claudio Osorio recruited the upper echelons of society from professional sports, retired military, and government leaders to serve on his board of directors, leveraging their reputations to enhance his own.

While I am a litigator and not a psychologist, this is clear to me: the talent of the fraudster is the ability to manipulate, develop trust and know how to tell people what they want to hear. Because most people are good and honest, they want to believe others are as well, especially when the source seems trustworthy. It is human nature to want to connect with others, as demonstrated by the pandemic's impact on mental health.

The perpetrators will invest substantial time in developing their credibility. Madoff was the chairman of the NASDAQ. Marc Dreier was a well-known attorney. Petters was a renowned philanthropist. What do they have in common? They are professional, skilled liars, expert in deception, and without empathy for others. And because a Ponzi requires a never-ending supply of new money to survive, the perpetrators typically cannot raise monies by themselves. They recruit (often but not always innocent) fundraisers, who in turn vouch for the schemer, thereby enhancing the effectiveness of the manipulation.

Given the number of Ponzi schemes, their magnitudes, their lengths, the failure of federal regulators to detect them, as well as the deception of sophisticated professionals, employees, and investors, the reason investors fall prey is not sinful "greed." Rather, it is the unique and deviant skill set of the perpetrators: the ability to deceive and manipulate others without remorse. The victims are not at fault. Recognizing this and removing any biases against victims of Ponzi schemes is critical to protecting their fair opportunity within the legal system to secure civil justice for the losses they suffered.

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