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You Won, Now Give It Back

In every Ponzi scheme, some investors profit early on. But courts can force them to return the money, even if they were unaware of the fraud.

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Evangelical Christians lost tens of millions of dollars to Gregory Setser, a Bible-quoting promoter from Rancho Cucamonga. But not faith healer Benny Hinn — he made $156,000.

Reed E. Slatkin, a Santa Barbara investment advisor who co-founded EarthLink Inc., cheated investors out of $240 million over 15 years. Actor Peter Coyote wasn't complaining, though — Slatkin made him a profit of nearly $1 million.

Dozens of wounded investors have haunted court proceedings for James P. Lewis Jr., the Orange County money manager charged with defrauding thousands of clients. But authorities found that about 450 other Lewis clients were up by a collective $72 million.

It can be a tough swallow for the losers, but many investment frauds depend on paying off some people so others will take the bait. In the 1920s, Charles Ponzi hooked so many fish with this lure that such schemes have been known by his name ever since.

Ponzi promised to double investors' money by trading international mail coupons. In reality, he just paid early investors with money from new suckers.

"One way to proliferate new investors is to pay old investors to become your promoters — 'Tell your family, tell your friends!' " said attorney Gregory J. Weingart, former head of the Justice Department's major- fraud unit in Los Angeles.

Indeed, without these winners to distract them, investors might have been skeptical enough to discover years earlier what authorities have charged: that Setser's import-export expertise, Slatkin's stock-picking prowess and Lewis' genius at turning around small businesses were fictions.

Although the investors who come out ahead rarely take the spotlight, the crucial role they play is well known to the court-appointed trustees and receivers who sort the wreckage when Ponzi schemes blow up. Hinn, for example, was approached by the receiver in the Setser case — not simply to return the money he made (as Hinn did) but also to encourage others to do the same.

Investigators also scrutinize the winners to see whether they have helped snare victims in return for big payouts.

In the case of J.T. Wallenbrock & Associates of Pasadena, authorities believe that at least a few of the investors were wise to shady practices. Wallenbrock, headed by Larry Toshio Osaki of Upland, promised clients a 20% return every 90 days. The company said it made money by advancing funds to latex glove makers in Malaysia, but the gloves were nowhere to be found.

The company took in an estimated $250 million over 10 years, and more than 750 of its 7,000 investors had turned profits when the Securities and Exchange Commission had the firm's assets frozen in 2002, said Steve Donell, an administrator for the receiver in the case.

Utah state officials charged two of the winners, Gerald and DeAnn Jones, with 11 felony counts in August. Authorities said the Utah couple collected commissions for signing up new investors and continued even after the SEC moved to stop the alleged scam.

In a deal to stay out of jail, the Joneses have agreed to plead no contest to four fraud counts on June 3, and they have already sold their home and cars to help repay investors, said their attorney, Kimberly A. Clark.

More commonly, winners in major Ponzi schemes are confronted with demands that they return their tainted takes under threat of lawsuits by trustees, receivers or losing investors.

In rulings dating to the days of Ponzi, courts have held that people can be required to return investment money paid by fraud artists — even if they were unaware of any wrongdoing, said R. Alexander Pilmer, a lawyer at Kirkland & Ellis in Los Angeles who represents the trustee in the Slatkin bankruptcy.

The reasoning is that the payments aren't returns on an investment but money effectively stolen from other investors.

Investors who acted in good faith are usually allowed to keep the amounts they initially invested, experts say. But in some cases, attorneys for losing investors have sued for the return of principal as well.

When the receiver in the Lewis case, Robb Evans, invited losers and winners alike to question him last month at a National Guard training facility in Los Alamitos, the winners lost no time venting anxiety over having to return their "profits."


Taking questions


Lewis' victims

(Beatrice de Gea / LAT)

One man said he was disabled and had no way to pay anything back. "I'm about to lose my house and my car," he said. He wouldn't reveal his name to a reporter.

A woman acknowledged that she had come out ahead but said that was only because she withdrew money from her Lewis account to cover living expenses after her husband died six years ago. Now, she said, that income and the entire nest egg she had counted on were gone.

"First we lost the money we thought we had," she said, "and now we are being asked to return money we don't have." She also declined to give her name.

Lewis, 57, who is being held without bail in Santa Ana as a flight risk, has pleaded not guilty to federal fraud and money- laundering charges and is scheduled for trial next year. He claimed to make money by buying and quickly reselling small businesses, raking in $311 million over 20 years.

Evans promised that he would not waste "emotional resources" seeking pittances from destitute investors but added: "We know how to get it back if it can be gotten back." He said those who came out ahead, even by modest amounts, should expect legal demands if they still have assets.

That warning was underscored in court May 10, when Evans' attorney, Gary O. Caris of Los Angeles, had to compete for permission to sue the winners. In a rival proposal, a group of class-action lawyers asked for permission to sue, telling U.S. District Judge Audrey Collins that they would represent the losers more aggressively.

Collins rejected that idea but listened attentively when Sean A. Okeefe, a Newport Beach lawyer representing 16 Lewis investors who turned a $3.7-million profit, urged the judge to order losers and winners to submit to federal mediation.

A court battle would lead to "a vast transfer of wealth between two groups of individuals," Okeefe said. "And it isn't between winners and losers. It's between the winners and the attorneys."

Collins held off on authorizing the receiver to sue winners, instead instructing Caris and Okeefe to meet in hopes of reaching a deal.

To some investors, the very notion that they can be sued comes as a rude awakening. But even people who lose money in Ponzi schemes can be sued — which happened to investors with Beverly Hills con man Gary Eisenberg.

Eisenberg had a business advancing money to garment manufacturers and used the firm as camouflage to swindle $21 million from about 200 friends and relatives, many of whom had more than one account with him. He pleaded guilty to fraud in 2002 and was sentenced to a five-year prison term.

Eisenberg's business ended up bankrupt, and the court named attorney Carolyn Dye of Los Angeles as trustee to recover assets to pay creditors. Dye's law firm, Weinstein, Eisen & Weiss, sued about three-quarters of Eisenberg's clients, adopting unusually aggressive legal strategies, said Paul J. Laurin, a lawyer for several of the investors.

Among the tactics was filing lawsuits over any account that came out ahead, Laurin said. An investor who made $50,000 on a regular savings account but lost $100,000 on a retirement account — becoming an overall loser — would still be sued, he said.

"They are coercing us to settle for astronomical sums," said victim Bob Steinberg, Eisenberg's half brother.

Dye and her associates "have been adversarial and terroristic," said investor Lindsey Berkson, who was battling arthritis and recuperating from a kidney-removal operation when she was sued last year.

"I have no money, no job, face another surgery, an uncertain health future, have no pension plan, and the trustees are suing me for almost $400,000," said Berkson, who turned down an offer to settle by having a lien of $83,000 placed on her home.

Dye said she tailored her legal actions to individual cases. She said that when it came time to make settlement offers on lawsuits, she allowed investors to keep returns up to their principal investment.

"I have bent over backward to be fair," trying to spread the pain of a dreadful situation as evenly as possible among the many victims, the trustee said. "It's a sad story for everyone. I'm not trying to make it sadder; I'm trying to make it more fair."

In another case, the receiver suggested that repayment would be the Christian thing to do. The winners in this instance included Benny Hinn, Marilyn Hickey and Reinhard Bonnke, all of whom have shows on the Trinity Broadcasting Network.

These televangelists, along with hundreds of other evangelical Christians, entrusted about $200 million to Gregory Setser and his Ontario-based IPIC. Setser claimed to earn big profits importing paint, garden knickknacks and other products but was arrested last year and is awaiting trial on fraud charges in Texas. He and four codefendants have pleaded not guilty.

The Dallas-based receiver in the Setser case, Dennis Roossien, sent a message to some of the prominent investors, suggesting that good Christians should return any profits so the money could be given to the neediest of the victims, such as retirees who lost their life savings.

Hinn, Hickey and Bonnke agreed, and with the blessing of a federal judge, a victims' compensation fund was set up. As of Tuesday, $1.9 million had been collected from the televangelists and their associates, Roossien said, including $156,000 from Hinn.

Roossien hopes that other Setser winners will follow suit.

"This will either be a very good story, or a sad commentary upon the church," he said. "So far, we are headed toward a tremendous testimony."

There have been few such easy recoveries in the Slatkin case, in which the legal fees have topped $22 million. Pilmer, the trustee's lawyer, said that a few investors voluntarily returned profits but that most put up legal fights, the last of which are still playing out two years after Slatkin surrendered to federal custody and admitted his fraud.

In addition to actor Coyote, investors who resisted repayment included television legal commentator Greta Van Susteren and her husband, anti- tobacco litigator John Coale. The couple made nearly $1 million with Slatkin.

"I'll fight this thing for 100 years," Coale vowed after trustee R. Todd Neilson threatened to file suit in December 2001.

In the end, Coale and Van Susteren, as well as Coyote, returned 80% of their profits under a deal with the trustee.

Still, about 100 claims remain against other winners, totaling more than $100 million, Pilmer said.

Some of these winners have filed for bankruptcy protection from creditors. One prominent Slatkin associate, Anthony Hitchman, left the country.

Hitchman invested $757,000 with Slatkin and received $4.5 million in return, according to a lawsuit Pilmer's firm filed against him in July 2002. A month later, Hitchman was in South Africa.

Reached by phone there, Hitchman declined to comment.

Pilmer, however, said Hitchman was a knowing participant in the scheme and vowed to pursue him through international courts, if necessary.

"We intend to exercise all of our legal rights to make sure that people like Mr. Hitchman cannot avoid repaying what they owe to the victims simply by moving halfway across the globe," Pilmer said.