IS SOUTHERN CALIFORNIA THE "KING" OF REAL ESTATE PONZI SCHEMES?

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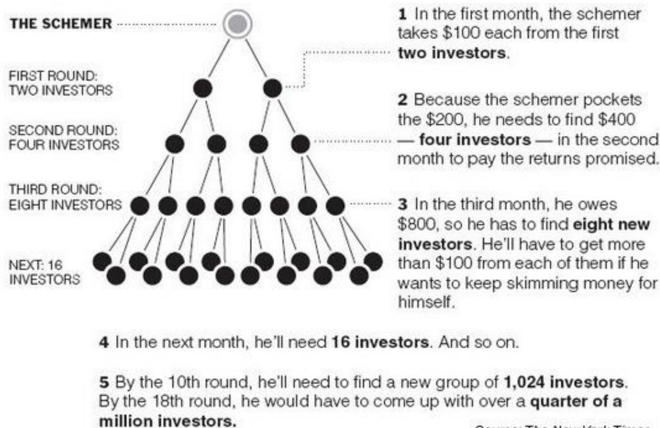
My partner and I have been practicing law for over 60-years combined and we practice primarily in the business litigation and bankruptcy venues. Over that time we have seen the S&L crash and burn, second-trust deed scams, Ponzi Schemes, and outright fraud consume millions of dollars from gullible Southern California residents. The same of the game changes over time but the themes are always based on outrageous rates of return of real property based investments. We should all know better than to believe that any real estate pool can consistently return double digit returns year over year without end. At some point in time the music stops and someone is left without a chair.



Woodbridge is the latest Ponzi Scheme in Southern California

On December 20, 2017, the Securities and Exchange Commission (the "SEC") filed an action alleging that the Woodbridge investment was a massive Ponzi scheme, and that new investor money was used to pay the returns owed to existing investors. The SEC also alleges that Woodbridge's business model was a sham, and that Woodbridge and Woodbridge's owner and President, Robert H. Shapiro, misused and misappropriated investor monies. The SEC also alleges that many of the properties Woodbridge purchased remain as vacant lots that have set undeveloped for several years. According to the SEC, nearly all of the purported third-party borrowers were actually limited liability

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[1] **Error! Main Document Only.** James Andrew Hinds, Jr. is a founding partner of Hinds & Shankman, LLP and is experienced in litigation and bankruptcy matters. Mr. Hinds has acted as first chair in a number of trials in state, federal and bankruptcy courts across the Country and has successfully handled hundreds of millions of dollars in asset value chapter 11 and 7 cases. Mr. Hinds can be contacted at jhinds@jhindslaw.com.

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companies owned and controlled by Woodbridge, which had no revenue, no bank accounts, and never paid any interest under the loans.

An independent management team has resigned from the Woodbridge Group of Companies after the SEC accused the firm of being a Ponzi scheme. According to news reports, the SEC also requested a court-appointed trustee to run the firm, which allegedly defrauded 8,400 investors after telling them it was fundraising for luxury real estate and to hand out loans to commercial property developers. Marc Beilinson, who served as independent manager, and chief restructuring officer Lawrence Perkins of SierraConstellation Partners LLC were part of the team that resigned. The duo took over from company founder Robert Shapiro, who resigned from his positions as president, manager and CEO in early December.

The SEC alleges that the commercial property developers, who were supposed to be securing loans through Woodbridge, were actually entities controlled by Shapiro. Shapiro is accused of stealing at least $21 million in company funds to purchase luxury items, as well as improperly combining investor funds. Shapiro allegedly took $328 million to repay early investors and doled out around $300 million on commissions and operating expenses.

Extravagant lifestyle

Since early December investigative reports and a review of the bankruptcy filings in Delaware show that Shapiro used $21 million of investor money to fund his extravagant lifestyle. A few examples include:

- $3.1 million to charter private planes
- $1.4 million on luxury designer goods such as Chanel and Louis Vuitton
- $700,000 on meals and entertainment
- $600,000 on political contributions
- $400,000 on jewelry
- $308,000 on wine
- $130,000 on country club fees

Shapiro has denied any wrongdoing, while Perkins said he was looking into the allegations. After filing for bankruptcy in December, Woodbridge was sued by the SEC to freeze its assets. “Mr. Shapiro is hopeful that Woodbridge management will not be inhibited in its important efforts by unnecessary litigation and administrative inefficiencies at the expense of creditors,” attorney Ryan O’Quinn said in an emailed statement. It is currently unclear whether those who sold securities for Woodbridge will face charges. The SEC complaint names only Shapiro, but some states have taken action against brokers.

How Woodbridge Operated

Under Shapiro’s stewardship, beginning in July of 2012, through December 2017, Woodbridge raised money by issuing promissory notes to investors in exchange for funds that it would purportedly use to offer commercial real estate buyers high interest mortgages, and through private placement subscription arrangements through which investors purchased units in Woodbridge funds. The promissory notes, or FPCMs, typically had terms of twelve to eighteen months and Woodbridge marketed them as paying 5%-8% annual returns on a monthly basis.

Once the twelve- to eighteen-month terms expired, and the time came to return investors' principal, Woodbridge would encourage investors to roll their investments over into a subscription offering or another short-term promissory note. The subscription offerings—the "Fund Offerings"—typically had five-year terms, and were marketed as paying a 6%-10% annual return on a monthly basis and, at the end of five years, a 2% accrued dividend and share of the profits. Neither type of investment was ever registered with the SEC or another state governmental agency.

Woodbridge represented to investors that it would use their funds for real estate acquisitions and investments, including in Woodbridge's own FPCMs. Woodbridge, acting through its own boiler room of salespeople and third-parties who were paid "commission" to peddle Woodbridge investments told investors that it would pay their returns from the interest a Woodbridge affiliate would earn from the commercial estate buyers who had taken mortgages from a Woodbridge affiliate at rates of 11-15%. According to Woodbridge's materials, these buyers were commercial property owners who could not obtain traditional loans and were willing to pay higher interest rates for short-term financing. Woodbridge told investors that their investment returns would be paid from the third-party buyers' interest payments, and promised them a first-position "lien" interest in the underlying properties, or priority over any other liens or claims on a property if the property owner defaulted. In fact, however, Woodbridge directly applied investor funds to pay other investors' returns.

Woodbridge also assured investors that their "loans" carried little risk. The "loans" were purportedly secured by the underlying collateral—the commercial properties that the third-party buyers would purchase with their funds. Woodbridge assured investors that the borrowers would be obligated to repay their loans after one year, and that in the event of a default, Woodbridge would foreclose and recover the balance of the loan. Woodbridge also told investors that the third-party buyers had mortgaged only about two-thirds of the value of the real estate securing the transaction with Woodbridge, touting "low loan to value ratios that help protect lenders [the investors] when borrowers encounter distress" and ensuring that the "properties that secure the mortgages are worth considerably more than the loans themselves at closing." Woodbridge further represented to investors that it had conducted all due diligence, including title search and appraisal, on the commercial property and borrower.

The reality as now determined by the SEC tells a different story. The majority of the purported third-party borrowers—the "owner" and "property owner" were hundreds of Shapiro-owned and controlled LLCs. The LLCs had no bank accounts or sources of income, and never made any loan payments to Woodbridge. Shapiro and his sales team concealed these facts from investors. Shapiro supported Woodbridge's business operations almost entirely by raising new investor funds and using them to pay returns to existing investors. Woodbridge apparently raised at least $1.22 billion from FPCM and Fund Offering investors but issued only approximately $675 million in "loans" for real estate purportedly securing the investments. Instead of generating the promised 11-15% interest, the loans generated only $13.7 million from third-party borrowers—far less than required to operate Woodbridge's business and pay investor returns.

Notwithstanding this shortfall, Woodbridge paid investors more than $368 million in interest, dividends, and principal repayments. Woodbridge spent another $172 million on operating expenses,

including $64.5 million for sales commissions and $44 million for payroll, and $21.2 million to support Shapiro's lavish lifestyle. (See below.)

To generate more investments, Woodbridge aggressively promoted the FPCM notes by offering incentives to brokers who recommended these investments to their clients. Woodbridge also established a program called "Pass It On," through which brokers were encouraged to inform their colleagues about the FPCM notes. Under that program, a referring broker would earn 25 basis points on each FPCM sale closed by a broker whom he or she referred. Between July 2012 and December 2017, Woodbridge raised more than $1.22 billion from more than 8,400 investors nationwide. On December 1, 2017, however, still owing more than $961 million in principal to investors, Woodbridge and Shapiro missed their first interest payments to investors. On December 4, 2017, Shapiro caused most of his companies to declare Chapter 11 bankruptcy. The Woodbridge docket shows that Woodbridge admits in its bankruptcy filing that it has less than $12 million in its bank accounts while having investor liabilities approaching $1 billion.

The Woodbridge Bankruptcy

On December 4, 2017, Woodbridge declared bankruptcy under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101-1532. Woodbridge has attempted to use this voluntary bankruptcy proceeding to procure a stay of the SEC subpoena enforcement actions. Woodbridge stated in the bankruptcy action that it is now transitioning to an institutional fundraising model and that it has removed Shapiro from control over the entities and replaced him with an independent manager. Nevertheless, Woodbridge agreed to keep on Shapiro as a consultant, pay him $175,000 per month, allow him to continue to use multi-million dollar Woodbridge-owned properties in Los Angeles and Aspen at below-market rents, and give him the authority to remove the supposedly independent manager.

In the bankruptcy proceeding, Woodbridge for the first time asserted the position that the FPCM noteholders, who comprise the vast majority of the creditors, with $750 million of debt outstanding, are in fact unsecured and should lose their entire investment. A footnote in the declaration of the newly appointed independent manager states: "It appears that few, if any, Noteholders have taken proper steps to perfect their interest in the Notes pursuant to either of sections 9-312(a) or 9-313(a) of the Uniform Commercial Code ("UCC"), which provide that a security interest in promissory notes (such as the collateral securing the Notes) must be perfected by taking possession of the underlying notes or by the filing of a UCC-1 financing statement describing the underlying notes, respectively."

The Debtor has confirmed that no Noteholder is in possession of any of the collateral securing the Notes. Further, on information and belief, and based on an investigation, no Noteholder has filed a UCC-1 financing statement with respect to any of the collateral securing the Notes in Delaware, the jurisdiction of the Funds. It therefore appears that any security interests held by the Noteholders is avoidable, such that the Noteholders' claims will ultimately be treated as unsecured claims in these Chapter 11 Cases. The Debtor intends to commence adversary proceedings seeking the avoidance of these security interests.

Under Orders entered by the Bankruptcy Court in Delaware and with the consent of the SEC, an independent board has been appointed and now management has assumed control over Woodbridge. New professionals have been retained to review the web of relationships between the FPCM noteholders, the new investors, the real property and notes held by Woodbridge, and the relationships between the Woodbridge entities. The cost to the Woodbridge Estate for this complete front to back scrub is about $1 million a month. For now, the emphasis of the new management team is on quickly liquidating as much of the Woodbridge real estate as possible, collecting cash, determining who invested when and how much, and who is a "winner" by having "redeemed" their investments prior to the chapter 11 filings.

Prior to Woodbridge there was Liberty Asset Management

How Liberty Operated.

Liberty Asset Management ("Liberty") was as a real estate investment company that bought and sold real property using a combination of its own cash, cash from investors, and bank loans. In the course of its operations, Liberty identified real property (and sometimes distressed asset portfolios) and solicited investors to purchase the properties. When Liberty started in 2007, Liberty used its own capital to buy and sell distressed residential real estate. In 2011, the business model changed and Liberty began acquiring, or attempting to acquire, major commercial properties using investor capital and third party loans to effect the purchases. Liberty lost more than $20 million between 2011 and 2013 on nonrefundable deposits for attempted acquisitions that never closed. Liberty did not purchase properties in its own name, and instead set up dozens of special purpose limited liability companies, referred to as "Investment Entities" that were capitalized with funds provided by Liberty.

Liberty received millions of dollars from investors for services ranging from the purchase and sale of specific parcels of real property to the purchase and sale of "portfolios" of distressed assets or mortgages. Typically, the Debtor and an investor entered into a contract to purchase and sell a target property, or pursuant to what is referred to as a non-specific asset management contract, and the investor would wire money to the Debtor in exchange for promises of above- market returns. Apart from self-dealing, there is also evidence that Liberty, through its principals, may have recklessly lost as much as $36 million of investor funds pledged as non-refundable deposits in an attempt to purchase major real estate assets. Liberty and its principals had no reasonable expectation of being able to rise adequate funding for such purchases, and were unable to fund such purchases.

As Liberty's model evolved into larger and larger deals, Liberty solicited investments from the Chinese community. Liberty solicited well-connected Chinese nationals to bring potential investors to Liberty and Liberty promised investors access to great "deals" substantial upside profit potential. Those bringing new investors to Liberty were promised a "split of the profits" defined as a part of the spread between the price paid by Liberty for the property and the price paid by the investors to acquire the same property.

When Liberty received wire payments from its investors, the money went toward general operating expenses and was not segregated for the purchase of any particular property. Money received from one investor for a designated investment property was deposited to an escrow, immediately withdrawn from escrow to an operating account, and used for everything from payroll, to a different property acquisition, to a

payment to another investor for a different investment. With 20-20 hindsight, Liberty's operations were fraudulent and by 2012, Liberty was operating as an alleged Ponzi scheme by using money from current investors as "operating expenses" to repay earlier investors. The alleged Ponzi scheme was growing momentum in 2011, and by 2014 had accumulated over $35 million of debt that could never be repaid.

Once forced into chapter 11 in Los Angeles, it was determined that Liberty's profit margin disappeared in 2012. Liberty's management team never reviewed financial statements to determine whether Liberty was making or losing money. As of the end of June 2012, Liberty owed $1.7 million to investors who remain unpaid today. By the following year, June 2013, Liberty owed more than $35 million to investors who remain unpaid today. During that time, Liberty was using money from investors to sustain operations, including losses on nonrefundable deposits and repayment of earlier investors.

The Liberty Bankruptcy

On March 21, 2016, Liberty commenced its case under chapter 11 of the Bankruptcy Code. On June 22, 2016, the Court ordered the appointment of Lawrence Perkins, the Debtor's chief restructuring officer ("CRO"), and gave the CRO full and complete access to the Debtor's offices for the purpose of securing possession and control, and copying all available books and records of the Debtor. However, a review of those records shows them to be incomplete and insufficient to permit an accounting of funds received and disbursed over the last four years. In particular, there has been no turnover of any complete and coherent set of accounting records (QuickBooks) or tax returns.

During the Liberty chapter 11 case, the Official Committee of Unsecured Creditors (the "OCC") acting by Order of the Bankruptcy Court has sold more than 10-real property assets and prosecuted claims against the management team at Liberty recovering judgments valued at $70 million. However, as with Woodbridge, the professionals hired by the OCC have earned fees in the millions thus effectively leaving the unsecured investors with little hope of a successful return of their investments with Liberty.

Lessons to be learned.

Based on a brief review of some of the most recent of Southern California Ponzi schemes, let's conclude with the "Lessons to be learned."

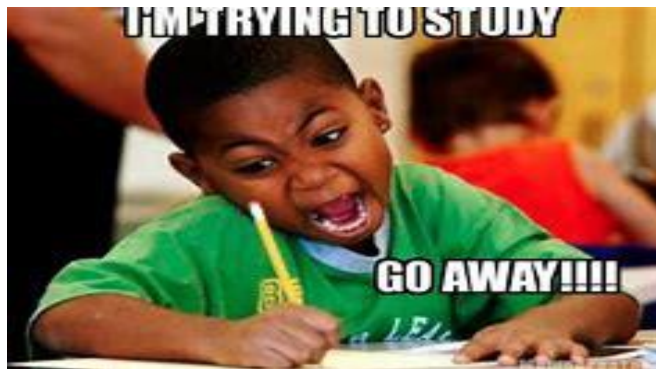
First, regardless of what you are told, most real estate based investments are securities under federal and state law. All investments – including the purchase of promissory notes – must be made through a licensed stock broker or registered investment adviser. Insurance salesmen are not able to solicit or recommend these investments unless they have the proper securities licenses. If you want to find out if your "financial planner" or "retirement planner" has a securities license run their name through FINRA's BrokerCheck database.

Second, there is a reason why it is very difficult to find investments that pay high monthly returns on a consistent basis; it's just not sustainable. Investments that pay monthly interest at above-market rates are, in my opinion, very likely to be a Ponzi scheme — or to turn into one eventually. There just aren't many businesses that can generate returns like that on a consistent basis.

Third, if your financial adviser recommends an investment in real estate based instruments with a guaranteed return make sure he or she has a big errors and omissions insurance policy, because that may be your only way to get your money back.

Since the beginning of time, California residents lose money by investing with friends, family or neighbors – people they knew and trusted. Investment fraud is a big problem here in California as it is all over the Country, largely because our close-knit communities are a prime target for "affinity fraud." Our state has a long history of financial scams and Ponzi schemes, many of which have been perpetrated by members of the South American immigrant community or the new minted Chinese immigrant community on members of their own communities. It's heartbreaking.

We have seen people who borrowed money against their homes or liquidated retirement accounts in order to fund risky investments based on pitch by someone they "trusted" because of a church or neighborhood connection. Unfortunately by the time they call a lawyer, the money is long gone – and sometimes so is the person who took the money. Because Hinds & Shankman is experienced in helping people recover losses in investment fraud cases, we often get asked for advice on how to avoid needing us. So, here is our top ten ways to avoid investing in a financial scam:



1. If it sounds too good to be true, it probably is. If you are thinking about putting money into an alternative, unregistered, or unregulated investment that promises abnormally high returns, watch out. The fact that others may have been getting their promised returns does not mean you will. All Ponzi Schemes eventually implode, and you may be left holding the bag.

2. Keep church out of investing. If someone pitching you an investment casually mentions that they used to be the padre or in some other church position, watch out! Church callings are not relevant to investment decisions. So beware of those who bring these issues up in an investment pitch.

3. Don't invest with friends and/or neighbors. It may seem like doing business with someone you know and trust would be safer, but that is simply is not true. All investing involves risk, and just because you trust the individual soliciting the investment does not mean that the investment itself is good. Trust but verify; and if things go badly do not hesitate to aggressively protect your interests.

4. Work through licensed stock brokers or investment advisors. We find that many times investment opportunities are presented at church meetings, social gatherings, and at private dinner seminars. Even when investing in a private

(unregistered) opportunity ask whether the promoter is licensed to sell you the investment, which regulator issued that license and whether the license has ever been revoked or suspended. A legitimate securities salesperson must be properly licensed under most circumstances. If you have any questions contact the California Department of Corporations, the Federal Trade Commission, the Security Exchange Commission, the State Attorney General, and the US Attorney.

5. Beware of secret trading strategies, offshore investments, commodity or currency (Bitcoin) trading, futures, options, and minerals. Generally, unless you are a well-informed investor, avoid anyone who credits a highly complex or secretive investing technique or touts unusual long-term success. Legitimate professionals should be able to explain clearly what they are doing and how they make money. Black boxes do exist and sometime they generate a rate of return which is extraordinary. And if the individual is really making as much money with their strategy as they say they are, they shouldn't need your money. These types of "alternative" investments nearly always involve extremely high risk, despite what you are told. Generally, stay in your comfort zone and know your risk tolerance.

6. Beware of guarantees. If anyone tells you that your investment is "guaranteed" that should cause you major concern and some heartburn. By their very nature all investments carry risk, and personal guarantees (especially oral ones) are rarely a means to get your money back. Even if you are approached to loan money and get a promissory note that is usually still considered to be an investment, and such loans can be very risky if not properly secured. If you are told that the loan or investment is "secured" hire an attorney to document the security interest and verify the collateral. (See Number 8.)

7. Get every rep and warranty in writing. We are amazed how often people will give hundreds of thousands of dollars to someone on nothing more than a handshake. Don't do it! If things go bad later, proper documentation will be critical to your efforts to get your money back. The terms of your deal should always be put in writing, and those terms should be reviewed by the competent attorney you hire. (See number 8.) In any private investment opportunity you should receive a detailed lengthy disclosure document called a private placement memorandum (the "PPM"). Take the time to review the PPM before you invest one dime. The PPM should contain detailed information about all aspects of the business including the business model, financial history, risk factors, and biographical information on the managers and owners, a list of any lawsuits, and the terms and conditions of the investment, among other things. If the company soliciting your money has not prepared a PPM that should be the end of your discussions with them and move on.

8. Hire an attorney. Hiring a good attorney up front is an investment in your investment. I acknowledge that attorneys can be expensive, but it is much cheaper to hire an attorney to document the transaction properly on the front end than to sue the bad guys when it all blows up. While the deal documents may be presented to you as "form documents," thus suggesting that no material alterations can be made, a good lawyer can help you perform due diligence on the company and individuals, and can determine whether the investment is properly structured as a private offering and complies with state and federal statutes. Your lawyer can review the offering materials and help you understand what the risks are.

9. Do your homework. Run a simple Google search on the company and its managers, or the individual who is pitching the promotion. If it involves a company, ask for a private placement memorandum and the company's financials. Hire an attorney experienced in real estate or business law to evaluate the investment

and help you perform due diligence. Attorneys have access to court databases to look for lawsuits and bankruptcies and news sources to check for bad press and fraud alerts. You or your lawyer can contact federal and state securities regulators see if actions have previously been taken against the company or individual promoters.

10. Slow down. Too many people invest after only hearing the pitch; watch out for promoters who try to commit you on the spot. Don't do it! Take your time, do your research, ask lots of questions, search the internet, review the promoter's financials, visit the company, kick the tires before you buy. Be very wary of aggressive sales pitches and deadlines. Ask the hard questions before you hand over your money, not after.