SCHEMES AND SCAMS PART II

In our previous article, we addressed the halachic guidelines of unwinding a Ponzi scheme. The issues discussed were how to distribute the schemer's remaining assets among his many victims, whether Halachah allows "clawbacks," under which investors who received phantom profits are required to return them to other victims, and whether a merchant must return payments that the scammer made, which in hindsight were from stolen funds.

We explained that Chazal instituted a takanas hashuk, that an innocent purchaser who was unaware that he was buying stolen goods[1] need not return them to the owner unless he is reimbursed for his purchase price. The original owner must compensate the purchaser for the amount that he paid for the item, and may then recover his belongings. The owner then has a claim against the thief for the amount that he was forced to pay the purchaser. Applying this to our case at hand, an innocent vendor who sold goods or provided services to the schemer would not need to return the funds he received, as the takanas hashuk would apply. However, a gift or donation received from the schemer would need to be returned, as gifts are not protected by the takanas hashuk.

The above would apply to phantom profits as well. If the scammer paid early investors "profits," which subsequently prove to be illusory, they are effectively treated as gifts to the investor. Even the principal returned would be construed as using stolen funds to repay a debt, which do not qualify for the takanas hashuk. Although the funds were accepted in the good-faith belief that the investor was entitled to them, once he learns the truth that they were in fact stolen funds, they must be returned. Thus, in contrast to civil law, even principal payments accepted in good faith may be clawed back.

However, this entire analysis presumed a simplistic case where the investor delivered cash to the scammer, who then distributed the cash to others. Because the cash belonged to the victim and was taken from him under false pretenses, the victim retains ownership of the cash, which is treated like any other stolen goods. An unwitting recipient must therefore return it to the rightful owner, subject to the limitations of the takanas hashuk. In contrast, modern Ponzi schemes typically involve wire transfers or checks that are deposited into the schemer's account. This raises a host of halachic issues, which are the focus of this article.

Shibud vs. Pikadon

When a person deposits money in a bank, the bank is not actually holding physical cash on his behalf; rather, the bank has a debt, a shibud, to the account holder.[2] When a person transfers funds via check or wire to a third party, the bank is not taking specific dollars that belonged to the account holder and giving it to the recipient. Rather, the bank, which had a shibud to the account holder, will now pay that debt to the recipient (or his financial institution). Thus, the account holder does not have direct ownership in any cash in the bank's vault that can be directly stolen.

Consequently, when a schemer defrauds his victim into wiring funds into his account, and then transfers the funds to a third party, it is incorrect to say that the victim's actual money is now in the possession of the recipient; what in fact happened is that the bank's obligation to the victim was inappropriately redirected. Thus, the bank is giving its funds to the recipient in order to satisfy the bank's debt to the victim.

Although this entire transaction was predicated on a fraud and the schemer certainly is liable for the losses that he caused, the victim cannot rightfully assert that the recipient is holding his dollars that originally belonged to him. While it is certainly true that the bank only paid the recipient because of the monies it owed to the victim, that does not create a direct ownership from the victim to the funds. As such, it would seem that this technical issue would preclude a victim from recovering from the recipient. Nevertheless, there are halachic arguments that can be made to justify clawbacks.

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The first is based on a suggestion of the Chazon Ish. Chazon Ish[3] discusses a case where a creditor sold a debt to a third party without notifying the debtor. After the sale, the creditor collected the debt that he no longer owned. Chazon Ish posits that the funds collected automatically belong to the purchaser of the note, since the funds were paid in satisfaction of the purchaser's debt. Perhaps this concept can be extended to a Ponzi scheme as well, and the victim can argue that any monies collected to satisfy the bank's original debt to the victim (which was fraudulently transferred) should revert automatically to the victim, who could then assert a direct ownership claim. If so, it would seem that the provisions of takanas hashuk would be applicable to such cases.[4]

In truth, however, Chazon Ish only considers this as a possibility and does not rule definitively on the matter. Additionally, a Ponzi scheme involves a second layer of transfers and other complexities, and it would be highly unlikely that a beis din would use this to enforce restitution from the muchzak (the party in possession).

Dina d'Malchusa

One of the most central questions regarding any Choshen Mishpat issue today is the concept of dina d'malchusa dina. When this concept applies, Halachah defers to the financial laws of a host country. While the parameters of dina d'malchusa are beyond the scope of this article, two points are in order. The first is that when a given issue impacts a large number of people, and especially when gentiles may be impacted, Igros Moshe states that dina d'malchusa will override strict Halachah[5].

In addition, in matters in which modern laws were created to address a new phenomenon or problem that did not exist in the days of Chazal, Halachah will often accept these rules even if they differ from Shulchan Aruch[6]. Accordingly, with the increased prevalence today of wire transfers and checks, an argument can be made that special rules and laws are needed to protect victims from various frauds, and therefore the clawback laws should be accepted by Halachah under the concept of dina d'malchusa dina.

In conclusion, while there is a significant technical halachic problem applying clawback provisions to Ponzi schemes, there is basis for beis din to uphold them regardless. This of course presupposes that an accurate forensic accounting can be made to attribute funds to their correct sources.

Distribution of Funds

A final issue that needs to be resolved is how the schemer's limited assets are distributed among his many victims. There are generally not enough funds to repay the victims in full, and the question is how much to pay each one. Shulchan Aruch[7] rules that if a debtor does not have enough assets to satisfy all of his creditors, each creditor receives the same amount regardless of the amount owed. The rationale is that the remaining funds are subordinated to each lender equally[8].

As an example, if there are three creditors, owed $100, $200 and $300 respectively, and the debtor has only $300 of assets, each creditor would get $100. If the debtor had $360, the per-creditor calculation would be $100, $130 and $130. Although this is the ruling of Shulchan Aruch, the Aruch Hashulchan and some contemporary poskim maintain that the prevailing custom is to prorate the assets based on the total debt outstanding. Continuing the above-mentioned example, if the debtor had $300, the payments would be $50, $100 and $150 respectively. If the debtor had $360, a pro-rated division would be $60, $120 and $180.

Therefore, a beis din would likely follow this custom (or close to it, on account of the halachic dispute), and distribute the schemer's assets in proportion to the victims' outstanding principal balance. Phantom profits, however, would not be included in this calculation. ■

1. This takanah applies only to metaltelin, movable goods, and not to real property.

2. See Chiddushei Rav Shlomo, Kesavim U'teshuvos, Siman 8.

3. Chazon Ish, Choshen Mishpat 8:15.

4. See also Nesivos Hamishpat 123:1 (biurim).

5. 7:62.

6. See Minchas Yechiel 123; L'horos Nosson 1:70; Chasam Sofer, Choshen Mishpat 43; Rav Henkin, Hapardes 31:7 for similar arguments.

7. 104.

8. Sma, ad loc., 27.

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