Rethinking Ponzi-Scheme Remedies in and out of Bankruptcy

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INTRODUCTION

A conventional Ponzi scheme, which temporarily sustains extraordinary returns by drawing on newly invested funds to make payouts to earlier investors, is normally a subject for criminal law.1 If the prospect of criminal penalties has not deterred the mastermind of such an enterprise, then, when the scheme runs its course, it is normally mopped up by bankruptcy law.2 The scheme lives longer and allows the perpetrator to extract and waste greater resources the more investors plow back their “profits” and the less intensely anyone investigates its details. As is often the case following large-scale tortious activity, legal remedies will be aimed beyond the primary wrongdoer to other parties.3 Thus, after Bernard Madoff stole, lost, and gave away about $18 billion, in what might have been the largest Ponzi scheme in history, a court-appointed trustee aggressively pursued second-best cost avoiders,

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3 See McDermott, supra note 1, at 158.
including investors who might have suspected that fraud was in progress.\footnote{See Letter from Stephen P. Harbeck, President, Sec. Investor Prot. Corp., to the H. Subcomm. on Capital Markets, Ins. and Gov't Sponsored Enters. (Sept. 7, 2010), available at http://www.sipc.org/pdf/2010%2009-07%20Cong%20Kanjorski%20Garrett%20Reply%20to%20Letter.pdf.}

Some of the facts and lessons of that case are discussed below.

In dealing with Ponzi schemes, bankruptcy law conceives of defrauded investors as armed with restitution claims, so that they become creditors of the estate, able to recover some of their principal in proportional fashion.\footnote{See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT §67 cmt. f (2011); McDermott, supra note 1, at 165.} If, however, there are investors who were in bad faith, the new Restatement (Third) of Restitution and Unjust Enrichment confirms and advances the notion that a claim might run in the other direction, so that the debtor’s estate can recapture, or claw back, these investors’ earlier withdrawals.\footnote{RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 cmt. g.}

The discussion in Part I begins with a review of, and some context regarding, current law. I argue that bankruptcy law might reinvent itself. Defrauded investors might be depicted not as creditors unable to collect their full restitution claims, but rather as equity investors. Some past payments to these investors might then be subject to recapture, not just as fraudulent conveyances but as mistaken distributions. The larger point is that bankruptcy law needs a reason to choose between competing characterizations of what transpired. I suggest that the right choice is the one that deters Ponzi schemes or minimizes losses. Part II goes a step further and argues that the harm done by Ponzi schemes might be minimized not by clawing back from investors who should have known better but rather by rewarding those who exited, inasmuch as it is exit that hastens the scheme’s collapse. It turns out that each of these three legal strategies makes use of restitution and that each creates problems for courts. Part III carries the loss-minimization goal, as well as the restitution remedy, to frauds that I label semi-Ponzis. In such a scheme there is a Ponzi-esque collective action problem without the likelihood of a geometric expansion and then collapse of a fraud.

I. REMEDIES FOR PONZIS

A. Current Law

There are many kinds of fraud, and it is unlikely that each requires a distinct remedy. Moreover, most wrongdoers who use new investors’ money to satisfy or make good ambassadors of old investors — a pattern that complies with the usual definition of a Ponzi scheme — will have dissipated a fair portion of the funds contributed by investors. Presumably, the primary target of a fraud investigation and claim is the wrongdoing organizer of the fraud. If this primary wrongdoer’s resources have been exhausted, and a prison term or
disappearing act is in the picture, then investors can expect no more than a fraction of their invested principal. If all those who suffered losses are in identical positions, the cleanup process known as bankruptcy is fairly straightforward. A court will assemble and assess the available assets, require proof of the original investments, and then distribute the available assets in pro rata fashion.

In most cases the investors are not all alike. Some will have extracted all or a portion of their original investment. Some may be labeled as “winners” because they have withdrawn more than they invested. Ponzi-scheme entrepreneurs rarely peddle debt with stated yields, so it is inapt to think of some investors as having received principal plus the opportunity cost of their money. Indeed, somewhat annoyingly, the litigated cases dismiss the idea of attaching interest to an innocent investor’s claim.

Generally speaking, the trustee in bankruptcy will begin the cleanup process by determining each investor’s net equity, which is to say the difference between the contributions and withdrawals, or payouts. The goal is to give each investor a pro rata share of the principal that has not been withdrawn but to allow innocent investors to retain any part of the principal now in their hands.

It is immediately apparent that law could make it easier (or harder) for the trustee to recapture payments made to Ponzi investors. As presently formulated, these recoveries are rooted in fraudulent conveyance law, which we might sloppily equate to bankruptcy law, because there is no obvious tort or unjust enrichment remedy against innocent investors. Fraudulent conveyance law gives the bankruptcy trustee a tool with which to collect surplus payments and, in some cases, even principal – though it is useful to think of the default

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7 See McDermott, supra note 1, at 158.
8 Id. at 163.
9 The illegitimacy of the enterprise seems to be held against the investor. See, e.g., McDermott, supra note 1, at 165 (“Furthermore, courts have emphasized that investors cannot characterize any payments they receive in excess of their principal investments as interest, reasoning that a debtor does not receive reasonably equivalent value simply because the debtor derived use-value from the investors’ money in order to perpetuate the scheme.” (citing Merrill v. Abbott, 77 B.R. 843, 859 (Bankr. D. Utah 1987))); see also Martino v. Edison Worldwide Capital (In re Randy), 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995); Dicello v. Jenkins (In re Int’l Loan Network, Inc.), 160 B.R. 1, 16 (Bankr. D.D.C. 1993). But see Restatement (Third) of Restitution and Unjust Enrichment § 67 cmt. i (contrasting ordinary restitution rules’ allowance of interest with bankruptcy courts’ interpretations of “reasonably equivalent value”); Baird, supra note 2, at 18-21 (arguing for the inclusion of interest for a fraud victim). The issue likely receives little attention because most Ponzi schemes collapse rather quickly so that it would be rare for the interest component to be considerable; any substantial profit, arising out of a high yield, will make the investor seem less than innocent.
10 See In re Bernard L. Madoff Inv. Sec., LLC, 654 F.3d 229, 233 (2d Cir. 2011).
rule as allowing innocent investors to retain principal they have withdrawn. Under 11 U.S.C. § 548(a)(1)(B)'s constructive fraud provision, the receiver may recover profits and principal with a showing of bad faith on the investor's part. Moreover, if the investor is deemed to be part of an actual fraud, which is to say there are badges of fraud about, including transfers in furtherance of the Ponzi scheme, then the investor bears the burden of proof; the trustee can recapture, or claw back, all that the investor has received unless the investor can show that he or she acted in good faith — as measured by an objective standard. It is not enough for the investor to show that he or she was duped; if a reasonable investor would have seen red flags and taken action, then all investors should do so. Ponzi schemes often exhibit many badges of fraud so that the innocent investor who has made withdrawals must show good faith. The new Restatement (Third) rehearses this rule when it quotes a well-known case:

In Ponzi scheme cases, if the circumstances would place a reasonable person on inquiry of a debtor's fraudulent purpose, and if a diligent inquiry would have discovered the fraudulent purpose, then the challenged transfer is fraudulent [i.e., the transferee is not entitled to a defense]. Some factors relevant to the analysis are the defendant's experience as an investor, whether the debtor promised rates of return greatly exceeding market rates, whether the debtor provided implausible explanations as to how it could pay those extremely high rates, and factors that would indicate insolvency, such as a debtor's use of postdated checks or history of dishonored checks. Facts sufficient to warrant a

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11 See Restatement (Third) of Restitution and Unjust Enrichment § 67 cmt. f ("The rule . . . allows a defrauded investor without notice to retain payments received from the commingled fund, but only to the extent that such payments reduce the amount of the investor's inchoate restitution claim against the wrongdoer. The effect of this rule is that an innocent payee may retain withdrawals or distributions up to the amount of his investment, but is liable in restitution for anything more."). The notion is challenged in a very few cases and discussed in the text accompanying note 26.

12 11 U.S.C. § 548(a)(1)(B) (2006). But see Meoli v. Huntington Nat'l Bank (In re Teleservices Grp., Inc.), 444 B.R. 767, 807 (Bankr. W.D. Mich. 2011) (suggesting that a trustee can never recover principal investments from an investor under the constructive-fraud theory because a trustee could never find "bad faith" on the part of a constructively fraudulent transferee so that "it follows that the recipient's awareness of the debtor's intent should also be irrelevant whenever avoidance is sought under this theory"). The decision is less dramatic than first appears because when the trustee cannot prove that the debtor operated a Ponzi scheme, it is unlikely that the trustee will claim that the transferee — subjectively — knew that the debtor was operating one.

13 But see In re Teleservices Grp., Inc., 444 B.R. at 810 (rejecting the objective standard and holding that a transferee will be held in bad faith when "in connection with receiving the transfer, he was aware that the debtor's purpose was all along to hinder, delay, or defraud his creditors").
Students of bankruptcy law will find all this familiar. Newcomers, however, may be grateful for another summary: the law takes profits away from all the investors in a Ponzi scheme (subject to a statute of limitations) and strips away (even) principal from those who should have known things were awry.

The preceding recitation of law elides over an important doctrinal step even as it fails to conceptualize the conventional, if not universal, view of bankruptcy law. In the simplest case, when a debtor is insolvent, those who have identifiable assets in the debtor’s hands can reclaim those assets, which the debtor has held in constructive trust. If the asset is missing, its owner becomes a creditor with respect to this negligent or wrongful act on the bailee’s, or fiduciary’s, part. An investor in a collapsed Ponzi scheme has just such a claim; if the assets have been commingled and cannot be traced, the investor’s position as a creditor derives from an unsatisfied restitution claim rather than the broken constructive trust. But even this restitution claim is thought to place the investor within the group of creditors that shares in the assets after those non-commingled ones are returned to their owners.

B. An Equity-Investor Approach

Bankruptcy law and its practitioners – excepting a very few outlaw courts – may have too readily accepted the conventional view of collapsed Ponzi schemes. An alternative is to think of the investors as equity investors in the enterprise. Imagine a shareholder who invests $1,000, receives 10 of 100 outstanding shares in an enterprise, is soon informed that these shares have risen in value to $2,000, and then withdraws $800, perhaps even from a non-commingled account. The example is meant to isolate a distribution to a continuing investor in what will eventually be revealed as a Ponzi scheme, but note that insolvency has not yet been introduced. A fundamental principle of bankruptcy law is to build on and honor non-bankruptcy law, and so it is useful to ask how this transaction would be treated. Tax law regularly treats the equity investor who receives explicitly pro-rata payments as receiving a dividend first and then (after earnings and profits of the company are

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14 Restatement ( Third ) of Restitution and Unjust Enrichment § 67 reporter’s note cmt. f (quoting In re Lake State Commodities, 253 B.R. 866, 878 (Bankr. N.D. Ill. 2000)). The Restatement (Third) follows with an illustration suggesting that the trustee can recapture payments regarded as withdrawals of principal only if they were received after the transferee has sufficient knowledge to be deemed part of an actual fraud under § 548(a)(1)(A). Id. § 67 illus. 19.

15 See Baird, supra note 2, at 12.

16 See id.

17 See id. at 11.

exhausted) as receiving payment in exchange of stock. If the payout is not proportional with respect to other investors, and there was no choice whether to receive a payout, then the investor is normally treated generously and is regarded as having sold back some shares to the redeeming corporation. Therefore, the withdrawal of $800 in the illustration above might easily, or best, be regarded as a partial redemption (of four shares, inasmuch as 800/2000 = 4/10) so that some of the proceeds are a return of the original investment and some amount to profit; the gain is $400 with respect to these four redeemed shares. If it later turns out that the enterprise was a Ponzi scheme, so that it was insolvent or otherwise unreasonable to have made the payout, the profit would surely be recaptured under fraudulent conveyance law so long as it was within the relevant statute of limitations. As for the $400 deemed to be a return of principal, conventional bankruptcy law would regard the transferee as enjoying a restitution action "the second the investment was made." There are other possibilities, but the important idea is that unless we are to be absurdly beholden to the valuation falsely claimed by the mastermind at the time of the distribution, we must redo the calculation and treatment after the fraud is uncovered. If at the time the withdrawal was made the shares were in fact close to worthless, then under the equity view there is a much better case to be made for (eventually) recapturing it all. One way to see this is to imagine the case where a shareholder invests $1,000; the shareholder is after some time completely redeemed for $2,000; and it is subsequently apparent

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20 See id. at 1034-39 (showing that actual treatment of non-pro rata redemption is friendlier to taxpayers than several plausible alternatives).
21 See Baird, supra note 2, at 19 ("Because the investment was acquired by fraud, the transferee had a restitution action against the debtor the second the investment was made.").
Case law on the matter imputed here is mixed. Some courts treat an explicit equity investment by an innocent Ponzi investor as hopelessly lost, while others convert it into debt. Compare Hayes v. Palm Seedlings Partners-A (In re Agretech), 916 F.2d 528, 540 (9th Cir. 1990) ("The partnership distributions here were not for value because Palm Seedlings-A made the distributions on account of the partnership interests and not on account of debt or property transferred to the partnership in exchange for the distribution."). with Barclay v. Mackenzie (In re AFI Holding, Inc.), 525 F.3d 700, 707-08 (9th Cir. 2008) (asserting that the limited partners have a restitution claim against the Ponzi operator and purporting not to overturn Agretech), and In re Int’l Mgmt. Assocs., LLC, No. A06-62966-PWB, 2009 Bankr. LEXIS 4242, at *30-31 (Bankr. N.D. Ga. Dec. 1, 2009) ("Consequently, the general rule that a Ponzi scheme victim has a fraud claim, the satisfaction of which to the extent of repayment of principal constitutes value in exchange for the transfer, applies regardless of whether the investment, in form, is debt or equity.").
22 If a court proceeds with the pro-rata approach and recaptures payments made to equity investors, it might try to calculate the "earnings" and interest on earnings that accrued to the investors, especially when the investors came aboard at disparate times. The calculation is difficult to make without accepting the numbers used by the mastermind, even though there is the danger that these have been created out of thin air.
that the firm was insolvent as early as the time of the redemption, when the proportional value of the shares was truly $300. Here the firm is surely best depicted as having made a mistaken payment of $1,700. If the normal pattern is to track non-bankruptcy law, then it is plain that outside of bankruptcy, setting aside a change-of-position argument, the investor must return the mistaken payment even if that means losing most of the original principal.23

Return now to the harder case of the continuing investor, and consider the case where the shares are again not worth $2,000 as claimed, but rather, say, $1,000. A sensible equity view is that, retrospectively, the $800 is depicted as a withdrawal of 80% of the principal, with the investor sharing in future prospects with 2 out of the 92 remaining shares.24 In tax terms we could say that the earlier capital gain will be balanced by a later capital loss. This equity reconstruction has some rough edges; the investor has not in fact parted with any of the original paper shares, and no voting rights have changed, but it is not as if the constructive-trust approach is without its own fictions.

A somewhat different equity approach is to characterize the investors as partners. A withdrawal by one diminishes that investor’s partnership share and, in the event of insolvency, can be re-characterized as a mistaken (over)payment. The trustee can thus pursue a restitution claim against the partner who received the early withdrawal. That seems less artificial than saying that the continuing partner has a restitution claim against the debtor but that this claim fails, or fails miserably, depending on the investor’s bad faith. A more straightforward story is that the mastermind induced many partners (or shareholders) to invest; if the enterprise prospers they all gain, and if it collapses they all lose their invested equity. If there are assets left to be distributed after distributions to true creditors, then of course the partners share in pro rata fashion. It should be noted that non-bankruptcy law, in this case partnership tax law, allows continuing partners who receive distributions to defer recognition of gain, so that the $800 would be depicted as a return of capital (in the manner of the constructive trust-creditor approach), though presumably subordinated to true creditors.25 In any event, it would be surprising if investors in a Ponzi scheme preferred to be thought of as partners rather than shareholders, inasmuch as partners do not enjoy limited liability, and many unsatisfied claimants can be expected. For this reason, as well as for

23 See Restatement (Third) of Restitution and Unjust Enrichment § 67 cmt. i (2011) (observing that the change-of-position argument under section 65 seems to be ignored in bankruptcy law); Saul Levmore, Explaining Restitution, 71 VA. L. Rev. 65, 92 (1985).

24 The money received can be thought of as proceeds of a sale of some of the stock back to the enterprise, in which case 11 U.S.C. § 510 (2006) provides that a claim arising out of the rescission of a purchase or sale of security (if not equitably subordinated) is subordinate to “all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.”

simplicity, the discussion proceeds with the shareholder version of the equity-investor approach.

Under the equity-investor approach, even a withdrawal of principal will be treated as a fraudulent conveyance, though mistaken payment is a nicer term. I should emphasize that the mistaken-payments idea is not found in bankruptcy decisions. There are, however, outlier cases that can be described as reflecting the intuition of the equity-investor approach, and it is possible that theorizing will stimulate judicial crafting along these lines. There are at least two approaches that can be conceptualized as the opposite of the equity-investor perspective. The first is the conventional constructive-trust notion. If an innocent investor in a Ponzi scheme had withdrawn $800 to pay for a medical emergency, the equity approach records the payment, or overpayment, of a dividend, but the conventional view treats the transaction as it would the repossession of a cow by its owner, and especially so if money can be traced by the investor. This investor will likely do better than those who did not withdraw funds before the insolvency came to light. This constructive-trust approach can apply even if the debtor is insolvent when the withdrawal takes place, because it is a withdrawal of the investor’s own property. A second “opposite” approach would be to focus on disassembling the Ponzi scheme rather than recapturing its withdrawn assets prior to distribution. Instead of ascertaining whether co-venturers in a scheme received non-pro-rata distributions, this approach aims to encourage the investors to discover that their venture is fraudulent and in need of termination, so that it will not further expand by sucking in others. Part II pursues this idea and argues for something very different from either the creditor or equity approach.

One could choose between the equity and constructive-trust conceptions based on the facts of the investments at stake. The more investors have reason to think of their money as maintained in separate accounts, and the more their investments are in fact disparate, the more appealing, or intuitive, the constructive trust model. When tracing is impossible, the creditor-restitution conception will then seem sensible. On the other hand, the more the commingling and the more the scheme began as a kind of mutual fund, the more fitting is the equity model. But in a pure Ponzi scheme, such as the infamous one masterminded by Bernard Madoff, it is hard to see why the form

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26 A model of this view is the dictum in SEC v. Forte, No. 09-63, 09-64, 2009 WL 4809804, at *5 (E.D. Pa. Dec. 15, 2009), available at http://www.paed.uscourts.gov/documents/opinions/09d1470p.pdf, where the court was disappointed with the SEC’s “policy” that “claims for principal should be asserted only against [investors] as to whom there is individualized evidence that they were on inquiry notice with respect to the operations of the [Ponzi scheme]” and grudgingly agreed to the Receiver’s request to go along with the SEC rather than litigate and attempt to recapture payments. There is also SEC v. George, 426 F.3d 786, 798 (6th Cir. 2005) (recovering funds from investors and paying little attention to restitution or bankruptcy doctrine), but in that case it is plausible that the lower court, as well as the appellate court, simply did not believe that the objecting investors – one of whom is described as the mastermind’s girlfriend – were innocent.
should matter. Investors may receive reports that make them think their funds are segregated, or they may think of the organizer as running a mutual fund—especially when so many of the investors come to the scheme through feeder funds. It is hard to see why the investors’ beliefs should matter more than the reality, which is not perfectly captured by either model. Law might, therefore, be thought free to characterize the matter as best serves some conception of fairness or some strategy for minimizing losses—especially if, as is true for each of the approaches compared here, the characterization derives from substantive law outside of bankruptcy.27

C. Lessons from Madoff

Even if we set aside the equity view as fanciful and take the creditor-restitution view as settled, there is the problem of ascertaining good faith.28 The real rule of law may have been misstated. The reported cases do not leave the impression that courts are adept at identifying investors who should have known better and who therefore lose some of the principal they might have thought they had withdrawn in time. Often when investors are found to have been in less than good faith, it is where they were promised that money would double or triple within the year.29 The rule might well be that an investor is safe unless promised the sort of returns associated with criminal enterprises.

27 In Madoff, an aggressive trustee might go further than the text’s re-characterization and say that every “shareholder” had the choice to receive something that looked like a 100% dividend; some took the dividend and some chose to reinvest the dividend, but obviously the entire dividend needs to be recaptured as a fraudulent conveyance when the correct dividend rate turns out to be zero or negative, except to the extent that it is too late to do so under the relevant statute of limitations. In re Bernard L. Madoff Inv. Sec., LLC, 654 F.3d 229, 236-40 (2d Cir. 2011). This is not something that bankruptcy trustees are accustomed to argue. So long as bankruptcy law accepts the idea that the defrauded shareholder has a claim that is immediately turned into one that provides creditor status, the law will not demand the return of principal in the manner suggested by some varieties of the equity approach, especially the mistaken-payment model. Moreover, the doctrine set out in Lobstein v. Lehn makes that creditor’s status an elevated one, so long as the creditor appears innocent. 12 N.E. 68, 69 (Ill. 1887); see also GARRARD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 260 (1940) (explaining that a creditor could have received the payment on account of unrelated debt).

28 Again, a court might go through the chore of determining actual as opposed to constructive fraud and might ponder good faith and bad faith, but in most of these cases it is the good faith of transferees that will be at stake. For a convincing analysis, see Baird, supra note 2, at 14-18. A failure of good faith can be deduced from omissions, so the determination is not always easy.

29 See Jobin v. Lalan (In re M & L Bus. Mach. Co.), 160 B.R. 851, 859 (Bankr. D. Colo. 1993) (“earning” between 125% and 512% on an annualized basis); see also Jobin v. McKay (In re M & L Bus. Mach. Co.), 84 F.3d 1330, 1338 (10th Cir. 1996) (promising 120% per year on two investments and 468% on the two other investments). The investments in these cases were purported to be “risk free.” Jobin, 160 B.R. at 859. See also Judge Posner’s comment in Scholes v. Lehmann:
If, however, the rule is as conventionally stated, then the messy facts of investment schemes combined with after-the-fact biases often make it unworkable. There is, on the one hand, the likelihood that every failed scheme will seem absurd after the fact. In 2010 the financial market was full of money managers who said that of course they did not invest with Bernard Madoff, both because they could immediately see that the rates of return he generated on paper were too good to be true and because there was a lack of transparency in his operations.  

Similarly, and in the same year, it was common to deride regulators and investors who had dealt with mortgage-backed securities in the preceding decade. When things turn out badly, the hindsight bias makes the production of these things seem absurd and wrongful.

On the other hand, there is an opposite bias – or simply a rational calculation – at the outset. If there are many investors in a scheme, and especially if sophisticated and large investors are among them, it is easy for an investor to think that it is rational and prudent to invest because so many others are doing so. This might be described as a bandwagon effect or as herd bias. Alternatively, it might simply reflect a collective action problem among investors if each thinks that some of the others must have investigated and been satisfied with their findings. At the very least, each might reason that the others did not find the promises and strategy of the organizer too good to be true. This collective action problem motivates the discussion in Part II.

Although a financial collapse does not prove that law is suboptimal, it is usually an occasion to rethink its structure and effects. The remedies available in the wake of a Ponzi scheme might therefore be re-examined following the recent, infamous, and giant scheme organized by Bernard Madoff. Over the course of twenty or more years – an unusually long period for a Ponzi scheme – Madoff leveraged his wealth management business into a massive scheme that eventually defrauded a great many investors, including universities and other charities, of billions of dollars. The court-appointed bankruptcy trustee, Irving Picard, estimated the losses at $18 billion, but investors relied on fabricated reports of gains and experienced nominal losses of more than $60

56 F.3d 750, 760 (7th Cir. 1995).


32 See Harvey Leibenstein, Bandwagon, Snob, and Veblen Effects in the Theory of Consumers’ Demand, 64 Q.J. Econ. 183, 184 (1950).
To be sure, the very real $18 billion would have grown significantly over all those years had the money been honestly invested so as to earn normal returns. A reasonable summary is that investors put about $36 billion in Madoff's hands and withdrew about $18 billion, with the other $18 billion missing—though some of that may yet be found in other investors' hands. Madoff was sentenced to a long jail term. On average it appears that the typical investor withdrew half the money invested in Madoff's enterprise. In fact, half withdrew more than they invested, and the trustee has recovered much of what was withdrawn in the last several years of the scheme's life.

The trustee has also turned to banks and other intermediaries that might have gained interest income and fees from investments in Madoff's enterprise. In yet more spectacular fashion, the trustee has sought to recover from large investors, especially from those who were personal friends of Madoff, not only because they should have known better and thus might have been in bad faith (and required to disgorge even the principal they recovered) but also because they may be co-conspirators who would be liable for all that went wrong. The trustee has extracted substantial settlements from some of these parties but has been stymied in some suits because of a court's ruling that any claim of responsibility on the part of some investors to others is a claim

33 Thus, a list of Madoff's victims typically shows about ten investors with more than $1 billion at stake, but these numbers represent paper gains rather than actual investments. See In re Bernard L. Madoff Inv. Sec. LLC, 654 F.3d 229, 231 (2d Cir. 2011). The paper gains, sometimes described as the Last Statement Method, are relevant for some purposes, but the Securities Investor Protection Act gives the trustee sufficient latitude to ignore the arbitrarily constructed paper record and to focus instead on the best possible reconstruction of the Net Investment Method of each investor. See id. at 235-38.


36 The relationship between the trustee's claims and the relevant statutes of limitations is beyond the scope of the present discussion, but it is noteworthy that although the trustee asserted control over distributions during the last six years of the scheme's life—and reached some settlements in the shadow of this assertion based on New York's statute of limitations—a court has now held that the trustee may look only to the last two years. See Picard v. Cohmad Secs. Corp. (In re Bernard L. Madoff Inv. Secs. LLC), 454 B.R. 317, 337-38 (Bankr. S.D.N.Y 2011).


that these other investors could bring, but it is not a claim that falls to the trustee, who steps into the shoes of Madoff.\(^{39}\)

My aim here is not to argue for any particular result in the Madoff affair, but rather to learn about bankruptcy and restitution law from it. It is obvious that the case as already unfolded confirms the difficulty of determining investors’ good or bad faith. More important and less obvious is the opportunity to ask what exactly might be expected of the good-faith, curious, skeptical, and even socially-minded investor. No one has yet suggested a claim against an investor who was suspicious from the beginning and chose not to invest with Madoff. There are many who have placed themselves in this category, and none seems embarrassed, or fearful of liability, for failing to rescue others. This is consistent with most of restitution law, which looks for affirmative enrichment, not to mention wrongful commissions, as opposed to omissions.\(^{40}\)

But even if we accept the conventional view of restitution, there is the question of what behavior law seeks to encourage. Fellow creditors and investors can hope that a sophisticated and skeptical investor blows the whistle on the developing Ponzi scheme before much money is lost. In the Madoff case, however, the Securities and Exchange Commission was called in numerous times to investigate Madoff’s enterprise.\(^{41}\) Any investor who knew that Madoff had been investigated could defend itself against a claim brought by the trustee by arguing that it relied on the SEC. Moreover, all investors, whether informed or not, could claim that there was no causal connection between their bad faith and the collapse. The best they could have done would have been to call in some authorized investigator, and the evidence is that the leading investigators did no good. No explicit doctrinal requirement of causation is associated with the good-faith/bad-faith distinction in bankruptcy, but the fact that the SEC was called in hollows out the trustee’s claim.\(^{42}\)

Madoff is not unusual in this regard. There are other cases where investors have lost because they fed the Ponzi scheme despite outrageously high rates of return but where they also knew that the Federal Bureau of Investigation or another authority had been informed that something might be amiss.\(^{43}\) Courts do not seem to hold this feature against the trustee, but it may be that creditors have not yet found their best argument in the courts. In any event, if the goal of law is to minimize the harm done by wrongdoers, or to deter wrongdoers, Madoff and other cases offer considerable evidence that the current approach needs some rethinking.

\(^{40}\) See Levmore, supra note 23, at 65.
\(^{41}\) See Kara Scannell, Madoff Chasers Dug for Years, to No Avail, WALL ST. J., Jan. 5, 2009, at C1.
\(^{42}\) See Baird, supra note 2, at 16.
\(^{43}\) In Teleservices, the branch manager had a background check run on the mastermind, and yet the court held knowledge of the inquiry against the transferee. Meoli v. Huntington Nat’l Bank (In re Teleservices Grp., Inc.), 444 B.R. 767, 829 (Bankr. W.D. Mich. 2011).
II. TOWARD DETERRENCE

The next step is not to suggest that law would be improved by moving to the equity-investor model sketched in Part I.B. It is possible that such an adjustment would be desirable, and I introduced it with this reasonable intuition in mind, rather than as a foil for what follows.\(^4\) Under the equity approach to Ponzi schemes, there would be a greater likelihood that an informed or skeptical investor would ask harder questions, would call the right authorities, or would otherwise help send the primary wrongdoer to jail earlier than would otherwise be the case. This investor would be motivated by the fear that withdrawals would be recaptured by a trustee who could characterize payments as a distribution of (false) profits, easily reversed under fraudulent conveyance or restitution law.\(^5\) In contrast and in review, current law normally allows the investor to regard withdrawals as first coming from principal, almost as if the investor were reclaiming chattel held in constructive trust.\(^6\)

On the other hand, sophisticated and risk-averse investors might respond to the imposition of the equity model by steering away from potential Ponzi schemes at the outset. Rather than investing and then investigating clues and blowing whistles to the benefit of all investors, the more sophisticated investors might avoid the scene altogether. This might reduce the number of Ponzi schemes because wrongdoers would have trouble attracting capital – which often follows leaders – but it might instead increase the number and lifespan of Ponzis because the second-best cost-avoiders will stay away.

It is tempting, not to mention trendy, to declare this an empirical question and then to note how difficult it is to gather empirical evidence or to run a natural experiment. The question is familiar to students of the law of rescue as well as to observers of tort law more generally.\(^7\) It arises when the obvious wrongdoer is known to be judgment proof or otherwise undeterrable.\(^8\) In some situations, the threat of liability against second-best avoiders might make the primary wrongdoer or other secondary precaution-takers believe that another party will take precautions.\(^9\) A strategic game can ensue, with over- or under-deterrence.\(^10\) In contrast, the mastermind of a Ponzi scheme is not less likely to take precautions because an investor will be required to make

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\(^4\) By way of full disclosure, I hope to use Ponzi schemes as a means of thinking about other kinds of cases, discussed in Part III, and the equity-investor model is not a tool that transfers well to these settings.

\(^5\) See supra Part I.B.

\(^6\) See Restatement (Third) of Restitution and Unjust Enrichment § 67 reporter’s note cmt. f (2011).


\(^8\) See id.

\(^9\) See id.

\(^10\) See id.
some innocent investors whole. In all these cases, empirical evidence is scarce.

My inclination is to focus on bringing Ponzi schemes to quick ends in order to minimize losses. The equity and creditor approaches penalize investors who should have known better, and they seek to distinguish completely innocent investors. If, instead, we seek to minimize losses but regard whistleblowing as too often ineffective, then the strategy ought to be one of encouraging investors to abandon suspected Ponzi schemes to bring about their collapse. Current law, and especially law as conceived by the Madoff trustee, might discourage sophisticated investors from exiting, both because their winnings are recaptured and because withdrawals might seem like evidence of bad faith. Current law might inspire a call to the legal authorities, and of course such calls should be encouraged even though they did not accomplish much in Madoff and in other cases cited above. But law could promote such calls, with carrots or sticks, even by investors who exit a scheme; whistleblowing can be encouraged independently of fraudulent conveyance law. Returning to the strategy of encouraging exit, think, for example, of an investor who had a pre-existing relationship with the mastermind and thus was drawn into the investment scheme. If this investor begins to think that returns are too high to be sustained or that the lack of transparency is troubling, the investor may want to exit but may be deterred because if it is, indeed, a Ponzi scheme, every after-the-fact investigation will suggest that the early withdrawal combined with the pre-existing relationship points to an absence of good faith. This investor will do better by staying aboard, awaiting opportunities for slow withdrawals. And yet it is likely that the best way to minimize social loss is to encourage such investors to exit because a Ponzi mastermind will have difficulty making payments to those who exit, and the exits will precipitate collapse.

The intuition, then, is that Ponzi schemes collapse because investors exit and that law might best minimize waste and losses by encouraging exit. If even a modest number of existing investors become skeptical and exit, the scheme will collapse unless the mastermind can repeatedly raise a great deal of new

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51 In the standard case, law might ask the second-best cost avoider to step in and assume part of the "missing" liability. See e.g., Evangelatos v. Superior Court, 753 P.2d 585, 590 (Cal. 1988). It would be interesting to see whether the cases that make up this trend give weight to the likelihood that one tortfeasor should have known that another would be judgment proof and then stepped up its own precautions. The point in the text is that a Ponzi mastermind does not expect to pay more in the end because another investor takes fewer precautions. There is not a strategic game among several tortfeasors who might try to give the impression that another should take additional precautions.

52 See Baird, supra note 2, at 7, 8, 19.


54 See Baird, supra note 2, at 14, 17-18.

55 See id. at 7.
money. The easiest way for law to bring about earlier collapses is to reverse the strategy determined by fraudulent conveyance law— as well as by the equity-investor idea— and allow investors to keep their withdrawals. Moreover, exiting works faster than whistleblowing. An extreme version would allow Ponzi investors to retain all that they extracted. A better version would allow an investor to keep an amount equal to principal plus a reasonable rate of return. In the event of bankruptcy, the investor would simply return any amount deemed to be in excess of this reasonable return.

There is room, however, to argue with this intuition that waste is minimized, or even welfare maximized, by bringing Ponzi schemes to quicker ends. The scheme itself largely transfers wealth from some investors to others, and this sort of theft has long forced the argument that the true social cost might have more to do with precaution-taking than with the theft. We have already seen that the precautions can be complicated, ranging from investigation and monitoring costs by investors, to preferences for some sorts of investments rather than others, and to unnecessary exits from and collapses of non-Ponzi enterprises. There is surely also some waste associated with the mastermind’s consumption of luxuries that is precipitated by the knowledge that the good life can come crashing to an end at any moment. In any event, I will continue to appeal to the intuition that it is desirable to end Ponzi schemes, and to do so quickly rather than slowly. In this light, the case for encouraging and even rewarding exit can be tied to the idea of an information market (or even a stock market) where we want everyone but manipulative insiders to contribute information for the common good. The fraudulent conveyance approach arguably discourages innocent players, who might have worthwhile inklings and small bits of knowledge, from selling and driving the “price,” or even the enterprise itself, to where it ought to go.

One nice component of the proposal advanced in this Part, that the law encourage rather than chill exits, is that law might be able to move seamlessly to it. Judges could decline to find fraudulent conveyances where the amount transferred was no more than principal plus the opportunity cost of investing elsewhere. There would no longer be a need to assess the good faith or bad

56 See id. at 4.
57 See, e.g., id. at 20.
60 See, e.g., Brian Ross, et al., No Apology from Ruth Madoff, ABC NEWS (May 20, 2009), http://abcnews.go.com/Blotter/story?id=7628205&page=1#.TzQ2jYHZeuI.
61 See Baird, supra note 2, at 14.
62 Judges could do this with no change in the statute, but rather an adjustment in the understanding of “value,” conforming to common understanding as well as the law of
faith of an investor, at least not in the way law has come to define those terms. In turn, suspicious investors would hasten to withdraw, and investigation would be modestly rewarded. Of course, the opposite reform, advanced earlier, that bankruptcy law encourage the equity-investor idea and thus claw back even more withdrawals, is also something that judges could bring about in common-law fashion.

It must be conceded that the proposal that law should encourage, which is to say reward, exits from suspected Ponzi schemes is not entirely free of decision costs, though these might be lower than those associated with determining good faith. Encouraging exit does require courts to identify truly complicit investors from those whose exit might hasten the scheme’s collapse. In a case where the mastermind fears that the fraud is about to be uncovered, there will often be quick distributions to relatives and friends, and it can hardly be a good strategy to encourage such (seriously or intentionally fraudulent) transfers by allowing their retention. Law must be able to recapture these transfers, or withdrawals, even as it encourages others in order to hasten a scheme’s collapse. This requires investigating the identity of the transferee, something not required under the equity-investor approach and not as strongly required under conventional law. Fraudulent conveyance law might even be returned to its roots under this proposal.

Once we tolerate or encourage exits from Ponzi schemes in order to minimize losses, there is the question of why we should limit the nonfraudulent conveyance to principal plus a modest rate of return. If we are prepared to reward those who exit early because they help future investors who would lose money in an expanding Ponzi scheme, then why not invest more in the deterrence strategy and allow the first to exit to take all that the mastermind assigns and pays out to him? One reason is to discourage side deals between the mastermind and an investor. If it appears that a Ponzi scheme is about to burst, the mastermind can assign inordinate profits to a collusive investor and encourage that investor to depart in return for hidden payments to the mastermind’s family or to some other favored cause. This preference, as we might call it, does not bring about the end of the scheme, and by depleting the available resources, it is likely to penalize the party who called in the authorities or otherwise brought the scheme to its final chapter.

See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 reporter’s note cmt. i (2011); Baird, supra note 2, at 20.

63 It is tempting to fine-tune the incentive and ask judges to calibrate it to the role played by the investor in ending the Ponzi scheme earlier rather than later. I think this is asking or expecting too much of judges.

64 See, e.g., Dana J. Lesemann & Peter B. Zlotnick, Receiverships and Other Shark Tales, Litig., Fall 2005, at 48, 51.

65 There is probably no additional need for courts to distinguish Ponzi schemes from normal business failures, so long as the proposal is to allow (no more than) withdrawals of principal plus interest.
An additional complication is that the promise of reward will cause investors to exit non-Ponzi schemes and bring about their collapse. Less obviously, unsophisticated investors will fear that their sophisticated peers will know when to rush to the doors, leaving the remaining investors to share a smaller pie. Investors may therefore be less likely to invest in perfectly good enterprises at the outset. Again, we do not have empirical evidence on these matters, and it will be difficult to assemble useful data. All remedies have similar problems. Even whistleblowing is costly, and it, too, imposes secondary costs. The conjecture here is simply that current law might discourage exit by investors who fear appearing knowledgeable, when in fact it is exit that best brings about the rapid and least harmful collapse of Ponzi schemes.

In sum, there are alternatives to current law with respect to Ponzi schemes. One approach is to discourage investments and encourage whistleblowing by holding more transfers out of a scheme to be fraudulent conveyances. I have suggested that, if investors in a scheme could be thought of as equity investors, then just such treatment would follow. A more radical approach moves in the opposite direction and rewards, rather than extracts from, those who first exit, unless they are truly part of the fraud. If we think of the goal of bankruptcy law not as the solution of a collective action problem among existing creditors but rather as the solution of the collective action problem encompassing both present and future, even unknown, creditors, then the best strategy is likely to be one of encouraging departures by those who suspect wrongdoing. Their calls on capital will hasten the scheme’s collapse. When viewed this way, it is possible to see the idea advanced here as a somewhat unorthodox example of restitution for unrequested benefits. The payment is


67 See supra Part I.B.

68 See Baird, supra note 2, at 7.

69 See Restatement (Third) of Restitution and Unjust Enrichment § 21 (2011) ("A person who takes effective action to protect another’s property from threatened harm is entitled to restitution from the other as necessary to prevent unjust enrichment, if the circumstances justify the decision to intervene without request. Unrequested intervention is justified only when it is reasonable to assume the owner would wish the action performed."). The restitution claim on behalf of the departing investor would be more straightforward if the action were taken purely to prevent the loss to another, and not to benefit the actor. See id. § 30 (providing a residual rule regarding unrequested interventions). This restitution claim would also be more straightforward if the money produced were a common fund, rather than the rescue of existing funds. My goal here is not to oversee a battle among restitution principles, but rather to suggest that both the equity approach and, now, the reward-to-exit approach can be framed within a restitution context in the manner of the conventional creditor characterization.
in the form of allowing those who depart to retain their principal plus reasonable compensation. The unorthodoxy is that it is uncertain whether this payment comes from those benefitted or rather on behalf of unknown future investors.

Finally, a system that rewards early exits, and especially one that limits these second-best precaution takers to their principal plus a modest rate of return, must decide how far back to look and pry. Some Ponzi schemes begin as legitimate businesses; no good will be done by reaching back twenty years to claw back withdrawals that exceeded principal plus modest returns. It is easy to say that here, as in virtually all settings, law can rely on a statute of limitations even though we cannot say why a particular duration was selected. For present purposes, it is perhaps sufficient to note again that Madoff was an unusually long-lived fraud and that in most cases we can reward or recapture with respect to every transaction affecting a Ponzi enterprise without exceeding familiar statutes of limitation. If some of the strategies discussed here were extended to the much longer-lived schemes discussed presently in Part III, it would be important to think carefully about statutes of limitation, interest rates, and retroactivity itself.

III. SEMI-PONZIS

The discussion in Part II assumed that Ponzi schemes could be identified after the fact. If, for example, investors in all tottering enterprises were encouraged to race to the exit doors, the genius of bankruptcy law would be completely undone. In normal bankruptcy, the trick is to treat investors equally to prevent contracts and departures that are individually profitable but collectively disastrous. Only when there is no real firm, and certainly none that might usefully be kept going, could it make sense to design legal rules that precipitate a collapse. The proposal attempted to be sensitive to this problem of distinguishing fraudulent schemes that are best discouraged at the outset and (if not discouraged then) ended as quickly as possible, by limiting the rewards associated with early departures to invested principal plus a reasonable rate of return.

Once we ask how to shorten the life of a Ponzi scheme and thus limit its damage, the question becomes one of deterrence rather than unjust enrichment. In contrast, the good-faith and bad-faith inquiries embedded in current bankruptcy law surely reflect (not deterrence but) the doctrinal and moral spirit of unjust enrichment. When deterrence is front and center, the key element of

70 See Baird, supra note 2, at 4-5.
73 See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 reporter’s note cmt. i (2011); Baird, supra note 2, at 20.
a Ponzi scheme is the collective action problem among present and future investors rather than either the pyramid structure of its financing or the fact that new funds are used to pay old investors. In turn, it is possible to see that the choice among restitution, liability for second-best cost avoiders, and early exits as remedies might be available, or usefully referred to, in other settings. I call these semi-Ponzis by way of conceding that they do not have all the elements of the traditional schemes.

In light of some recent lawsuits, consider the example of claims that might be brought against a law school that published and advertised misleading employment statistics. Imagine an institution where 20% of a typical graduating class secures jobs for which a law degree is normally a requirement, and yet the school advertises an 80% figure. It is not obvious that a recent graduate, who suspects or even knows of the misrepresentation, can succeed in a lawsuit. If the graduate is well employed, it is difficult to show injury; if the graduate is unemployed, it will be difficult to show that with full information this individual would not have attended the (hypothetical) law school and would have been better employed after attending another school or choosing a different career path. The disappointed graduate can argue that tuition was paid and loans taken out under false pretense, but liability probably follows only if courts adopt a heeding presumption as they do in some but not all other settings. Nor is it clear that a class action could succeed or that a class's damages would be less speculative. The plaintiffs' claims are certainly not all alike. A restitution claim against the institution for unjustly received tuition payments, or against faculty for unjustly enjoyed employment, might also be expected to fail because the students who attended were educated. Deficiencies in their education are also hard to prove and difficult to distinguish from what occurs at competing institutions where there is no misrepresentation of employment statistics. Plaintiff's best chance is to hope that a court would be willing to calculate a fractional recovery. Thus, a plaintiff might argue that, absent misrepresentation, the school could have filled its classes only by charging a lower net tuition. If comparable schools charge less, then this claim is not purely speculative. Restitution, then, might play a larger role with respect to semi-Ponzis.

It is easy to see how such frauds can continue and why claims against the school are unusual. Few people have access to the school-specific employment data, and their careers might depend on hiding the graduates' disappointments. Individual students might begin to doubt the school's

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reports, as they come across unemployed classmates, but anyone who suspects the truth is better off remaining silent because disclosure is likely to hurt the school’s reputation and thus the employment prospects of the individual student. The same is true for misrepresentations regarding admissions data, though it is perhaps less likely that the typical student would be aware of other students’ test scores and grades. Moreover, the misrepresentation of admissions data can go on indefinitely; increasing numbers of unemployed alumni will probably lead to the collapse of the employment-reporting scheme, whereas nothing short of whistleblowing or confession brings about the collapse of a scheme in which standardized test scores, among other attributes, are exaggerated. In this way, the students are like Ponzi investors; some are the second-best cost avoiders but virtually all have reason to help keep the scheme going, at least until they exit safely. It is this feature that distinguishes such a semi-Ponzi from run-of-the-mill frauds or disappointments that prey on non-repeating customers. At least in the case of employment data, it is hard to imagine that a very large difference between actual and reported figures could go unnoticed by sociable students. At the firm level, bankruptcy is unlikely. Federal loans and barriers to entry ensure the survival of most schools, though fraud, once revealed, is likely to bring about the ouster of current management. In any event, the fraud has some things in common with conventional Ponzi schemes. Participants have a private incentive not to publicize the fraud, at least before they have extracted their investment and the gains they seek. Students who have been duped into matriculating might also benefit from other students’ taking their places. It is useful to draw attention to the Ponzi-like characteristics of such frauds if the remedies that might deter the conventional schemes could do good work here.

In the law school setting, whistleblowing by a disgruntled student or employee is the most likely path to disclosure, reform, and a better matching of applicants, schools, and employers. Additionally, early exit might play a role. If students expect the fraud to come to light before long, then we might expect more students to transfer out of such a school. A substantial number of transfers might influence the school’s administration even more than would a substantial number of dropouts. This is obviously the case if the students who transfer out feel more secure and spread news of the likely misrepresentation. A remedy styled on fraudulent conveyance or modern tort law (with the idea of second-best cost avoidance) seems abhorrent rather than useful. Disappointed and unemployed students might bravely imagine a restitution claim against recent graduates with remunerative employment. While these graduates have not received anything resembling fraudulent conveyances, they might be regarded as unjustly enriched. They should have noticed that they were in a small minority and that the claim of 80% employment was false. They might have discerned that the misrepresentation was likely designed to induce potential applicants and employers to think well of the school. Had they acted to end the fraud, the majority of students who followed them might well have
elected to attend other law schools where the employment statistics were much better than the true statistics at the offending institution.

These fortunate but silent graduates are secondary cost-avoiders at best and – unlike a conventional Ponzi scheme and unlike a standard tort case where gatekeepers or other second-best cost-avoiders become implicated – the superior cost-avoiders have not been driven into bankruptcy. The claim against the school and its employees is weak enough, and surely better than that against successful but selfish graduates. Recovery from these graduates, who did not receive anything tangible that would otherwise be available for distribution among other students, would seem more of an insurance scheme, replete with moral hazard, than a solution to a collective action problem.

Such semi-Ponzis do not quickly collapse with exit, but they have enough in common with conventional Ponzi schemes. Both varieties would come to light with a careful audit, and in both cases a collective action problem makes such an audit unlikely. In both settings there is no good way to differentiate perceptive calls for an audit from disruptive and unnecessary ones. The restitution remedy is used when conventional Ponzi schemes are uncovered and sorted out, but as compared to the alternatives discussed above, it plays little role in deterring fraud. The remedy plausibly would do better for semi-Ponzis, but it is the use of that remedy against the primary wrongdoer that is more promising, if less academically interesting, than against second-best cost avoiders who once shared in a collective-action problem.

On a much larger scale, forms of government debt can be described as semi-Ponzis. Price bubbles also have Ponzi characteristics, and if the bubbling has roots in fraudulent activity, such as manipulative asset valuations that are known to many but not all participants, there is an argument for Ponzi-scheme remedies. In the case of public debt, one generation can splurge at the expense of the next, and an eventual reckoning is inevitable even if there is no geometric expansion of the borrowing. On the other hand, there is no fraudulent activity to bring to light. Of the remedies discussed here, only the fraudulent conveyance approach seems apt, but it is unlikely that courts would force beneficiaries of government programs to return their windfalls so that the next generation does not pay the price. Moreover, there is no need for a whistleblowing incentive, inasmuch as the magnitude of the debt and the intergenerational transfer is widely known. In any event, the problem is sufficiently large-scale that a majority must vote for a tax system that brings

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75 See supra Part I.C.
76 See supra Part I.C.
about this result – and then the next generation must fear such a tax in order to be deterred from running its own Ponzi-like scheme.

In the case of over-leveraged housing, however, exit (in the form of individuals’ selling houses and moving capital to other assets) eventually brings about collapse. In the recent U.S. experience, there was also evidence of wrongful behavior and fraudulent real estate assessments carried out in order to qualify applicants for loans and to bundle and sell these loans. There would have been a social benefit to a quicker collapse because there would have been less overbuilding. A retroactive tax on appreciation in housing, with the revenues used to mitigate the costs of foreclosures, and especially the negative externalities caused by vacancies and foreclosures, might be reasonable. If so, it is a case where insurance and (slightly unjust) enrichment are more attractive than rewards for early exits. It is interesting that no one proposes recapturing gains from the net winners with the scheme just described or anything like it. The discussion here suggests that this might be because we intuit that the exits are in fact desirable and ought not to be discouraged.

**CONCLUSION**

I have encouraged the notion that, where Ponzi and semi-Ponzi schemes are uncovered, law might focus less on unjust enrichment and more on deterring misbehavior and social waste. In the case of Ponzi schemes, bankruptcy law might encourage exit in order to hasten the collapse of fraudulent enterprises. If this is too radical a change, then I have also questioned bankruptcy law’s characterization of Ponzi schemes and suggested that it could go much further in recapturing investors’ withdrawals. In other fraud cases, where there is likely an ongoing and worthwhile enterprise, there is opportunity for novel restitution claims.

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