Rothstein's Onion Peeled Back

The many layers of Scott Rothstein's Ponzi scheme continue to be peeled back, revealing a tangled web of Madoff-like feeder funds, alleged co-conspirators, and vast sums of money being transferred throughout the world.

The Miami Herald reports, here, that Rothstein moved money to Venezuela, Switzerland and Morocco, and used dummy Delaware corporations to disguise his ownership stakes in real estate holdings and other assets. The Miami Herald also reports, here, that a feeder fund may have contributed close to $2 billion to Rothstein over a 2 year period.

Unfortunately, the media's focus has been on Rothstein's opulent living arrangements, including fancy cars, boats, condominiums, watches and mansions. These assets, as dramatic and sensationalistic as they are, represent but a miniscule portion of total contributions by investors. Even assuming that Rothstein accumulated $100 million in trinkets, baubles and cars, that still leaves the vast portion of the money unaccounted for. For those of us unaccustomed to wealth, it is incomprehensible to understand how difficult it is to spend vast sums of money on tangible goods and assets. No, most of the investors' funds were not spent on Rothstein's junkets, but were likely dissipated throughout the world in a flurry of wire transfers, and are quite likely parked in exotic locales that have poor regulatory structures or banking laws.

Investigators will first determine the amount of gross receipts into Rothstein's funds. This will be accomplished through interviews with investors or bank statements and records, assuming, of course, that suitcases packed with cash were not the primary mode of receipt by Rothstein. Investigators will also marshal the remaining tangible assets and attempt to reconcile Rothstein's expenditures and cash outlays. Even assuming a wide margin for error and unknown expenditures, investigators should know with some degree of accuracy the amount of missing funds. As difficult as it is to spend hundreds of millions of dollars on tangible assets, it is even more difficult to legally move these funds throughout the world without leaving telltale signatures and audit trails. Following the dissipated money throughout the world will be time-consuming but not terribly difficult or challenging. The challenge will be in recovering the funds, which have likely been withdrawn or divided into much smaller "packets" within the recipient countries. Pursuing these funds into jurisdictions unfriendly or hostile to the United States may become the Achille's heel of the investigation.

As the lawsuit in the Herald article indicates, it is impossible to conceive of a fraud of this magnitude that did not involve co-conspirators or at least "fraud-friendly" acquaintances. The mere act of recordkeeping, reconciling, transferring, and manipulating vast amounts of money requires a team of personnel, each of which understood that a fraud was occurring or likely. At a minimum, Rothstein's garish lifestyle must have triggered alarm-bells in his colleagues, partners, associates, and bankers. Lawyers, even top-litigators, simply cannot earn "stupid-money". Even if Rothstein's role as money manager was factored into his lifestyle, potential investors must have questioned the size and scope of the legal settlements that served as the basis for their investments. Did no one, colleagues or potential investors, deign to ask, "Where and from whom is Scott obtaining legal settlements sufficient to generate these returns"? Did lawyers in the firm compare notes and determine which partner or associate was performing work or billing on these cases, even if not filed in court yet? Again, this was a spectacular failure to perform due-diligence and demonstrates that crowds of purportedly intelligent professionals and entrepreneurs can be easily duped and misled.

Further, even assuming the legitimacy of these structured settlements, Rothstein's commissions could not have generated the funds required to fuel his extravagant lifestyle, which reportedly cost Rothstein at least $10 million per month. Finally, lawyers at the firm must have understood or could easily have performed back-of-the-napkin calculations regarding the firm's expected gross revenues and expenditures. The discrepancy between these two numbers should have alarmed these folks, who may now become defendants in dozens or hundreds of civil, if not criminal actions. Complicit stupidity or active fraud?