ONE HUNDRED YEARS IN PRISON FOR $126 MILLION FRAUD

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CASE DESCRIPTION

This case examines the multimillion dollar Ponzi scheme perpetuated by Edward Okun. Okun was convicted in 2009 of 23 counts including wire fraud, money laundering, bulk cash smuggling and other offenses. In this case, students will learn about fraud, money laundering, federal currency reporting requirements, aspects of tax law, and ethics. This case is suitable for either undergraduate or graduate students. It can be used in an Introduction to Business, an Ethics, or a Fraud course. Students typically require 2-3 hours outside of class to complete the case. Approximately one hour of class time is needed to go over the case. This case can help students develop both written and verbal skills.

JEL: M40, M42

KEYWORDS: Ponzi scheme, fraud, money laundering

CASE INFORMATION

Introduction

In December of 2005, then 54 year old Edward Okun is dancing at his lavish $200,000 wedding. He is surrounded by his new 27 year old wife, many current and prospective clients, and his two dogs who are dressed in wedding attire! In the course of just one year he has divorced his former wife, acquired a multimillion dollar yacht, an estate in Miami, and numerous other expensive cars and aircraft.

Now fast forward to August 2009. Edward Okun is standing before a judge being sentenced to 100 years in prison for a $126 million dollar fraud including conspiracy to commit mail and wire fraud, wire fraud, conspiracy to commit money laundering, money laundering, bulk cash smuggling and perjury. He is surrounded by victims of his Ponzi scheme including eight victims testifying as to the pain and suffering he has caused.

Tax Law

How did this happen? Okun was the owner of several companies including Investment Properties of America (IPofA), The 1031 Tax Group (1031TG) and Okun Holdings, Inc. The 1031TG was named after Section 1031 of the IRS tax code. Normally when an individual sells a piece of property, that person is taxed on any gain from the sale (called capital gains). However, Section 1031 of the IRS code allows investors who sell real estate to defer their capital gains if they reinvest in similar investment property within 180 days. This means that they will not have to pay taxes on the gains until a later date. These transactions are called like-kind exchanges or 1031 exchanges. The investor has 45 days to find a replacement property and 180 days to complete the purchase. To qualify for the capital gains deferral, the cash proceeds from the sale (called exchange funds) must be deposited with a qualified intermediary (QI) until the like-kind exchange is completed. The QI acts like a safe harbor and keeps the money until the new property is purchased. Exchange agreements are signed and the intermediary holds the exchange funds in trust for their clients. The funds are to be used for 1031 exchanges only.

The problem is that there is no regulatory oversight of these financial intermediaries. There are no registration or certification requirements for qualified intermediaries even though their purpose is to safeguard investor funds. The investor is not really protected. This allowed Okun to withdraw millions of dollars from his QI companies to buy other QI companies in a massive Ponzi scheme to keep the scam going so that he could bankroll his lavish lifestyle, pay for expenses of his other companies and invest in commercial real estate. According to court documents, from August of 2005 to April of 2007, Okun and his associates misappropriated approximately $126 million of client's funds. Okun would purchase QI companies and illegally withdraw the client funds. When he needed more cash to finance his lifestyle or to fund an exchange transaction to keep 1031TG solvent, he would simply buy another QI company. 1031TG was the parent company to all of the other QIs that Okun purchased. Okun orchestrated a Ponzi scheme in which new clients' money was used to pay back earlier clients' money and also used for Okun's personal life, including jewelry, jets, cars and houses.

Scenario

The information in this section and subsequent sections was obtained from the indictment filed in the United States District Court for the Eastern District of Virginia as well as media coverage of the trial unless otherwise noted. It began at the end of August 2005 when Okun purchased a QI called Atlantic Exchange Company, Inc. (AEC). The exchange funds of the company were to be held in interest-bearing escrow accounts to be used to complete the exchange transactions. According to the indictment, soon after the purchase of AEC, Okun wired millions of dollars of AEC's client funds to his personal bank account, IPofA accounts, and another account partly to repay the money that he had borrowed to buy AEC. This was in direct violation of AEC's exchange agreements. AEC was supposed to hold the client funds in a safe harbor so that when clients were ready to purchase their next property, the funds would be available. These funds, however, were used to support Okun's opulent lifestyle, fund his divorce settlement of approximately $6 million, pay exorbitant salaries to top executives, cover expenses of his companies, and purchase commercial real estate. The same scenario was repeated from November of 2005 to the end of 2006 with Okun purchasing five additional QI's and misusing the exchange funds in similar ways.

The scheme began to unravel in 2007 when 1031TG was unable to fund client exchanges when due. Okun and his conspirators continued to misappropriate client funds, making payment to earlier clients with funds from later clients. Finally, some clients began to threaten to contact the authorities. Okun then obtained a personal loan, using collateral originally purchased with misappropriated 1031TG funds, from a third party lender. The loan was forwarded from Okun's personal account to 1031TG's account and then to the clients. This was done with the intent to conceal the source of the funds. The 27 count indictment against Okun was filed in 2008. The counts on the indictment consisted of wire and mail fraud conspiracy, money laundering conspiracy, wire fraud, mail fraud, money laundering, bulk cash smuggling and false declaration (perjury).

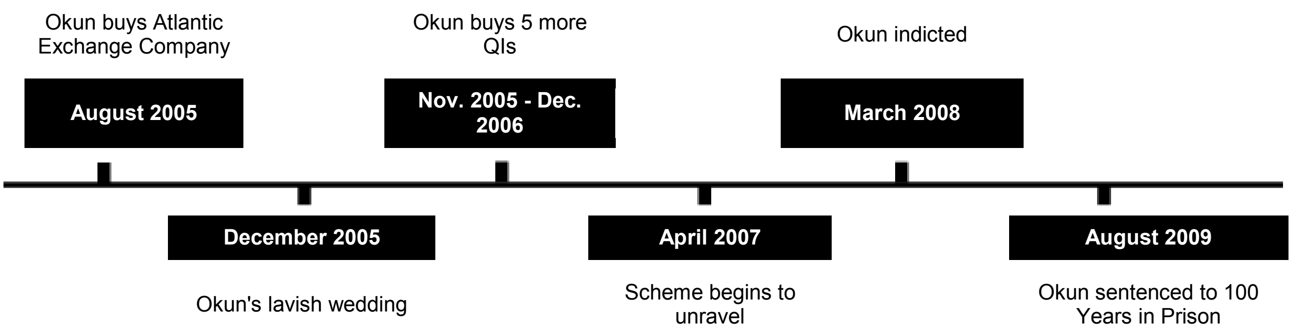
Accomplices

Who were Okun's accomplices? A major player in the Ponzi scheme was Lara Coleman, Chief Operating Officer of IPofA. As COO, she was a participant in the misuse of client exchange funds. She was involved in the illegal transfer of client exchange funds into IPofA from the QI companies and the illegal transfers out. Robert Field II, a Certified Public Accountant and Chief Financial Officer for Okun Holdings, Inc entered the scene in August of 2006. Initially, all information regarding the misappropriations of 1031TG client funds were withheld from him. However, in October of 2006 an IPofA employee told Field about the misuse of client exchange funds. Field informed in-house counsel of 1031TG and hired outside counsel to review the transactions. Subsequently, both in-house and outside counsel resigned after multiple attempts at informing Okun, Coleman and Field that the use of the client

exchange funds was likely in violation of state and federal laws, that such conduct must cease, and that all misappropriated funds must be repaid immediately to the multiple QI entities owned by Okun.
Next entered Richard Simring, an attorney, who advised Okun around November 2006 that he must rectify the situation at 1031TG so that funds would be available for exchange transactions as they came due. Simring warned Okun that he could go to jail if this was not done. Okun agreed to pay back most of the funds to 1031TG. However, in late November it became nearly impossible to fund the 1031 exchanges for clients because Okun had taken so much money from the QI companies. So, to get his hands on more cash, Okun purchased another QI, 1031 Advance, and fraudulently used those exchange funds. At the beginning of 2007, Simring was hired by Okun to be Chief Legal Officer for Okun Holdings, Inc.

Finally, by April 2007, they were running out money again. The QIs were unable to come up with the cash when their clients purchased replacement properties. To cover this up, Coleman, Field, and Simring misappropriated client exchange funds for "lulling" payments to 1031TG clients. They took cash deposited by later clients to pay for the exchanges of earlier clients. The CEO of 1031TG then resigned and was replaced by Simring. Okun continued to misappropriate funds, assisted by Coleman and Simring, until they ran out of money and finally on May 13, 2007, 1031TG filed for Chapter 11 bankruptcy. Figure 1 below shows a timeline of the relevant events.

Figure 1: Timeline of Events



<u>The Trial</u>

In his opening statement at the Okun trial, the prosecutor told the jury that Okun viewed the clients' exchange accounts "as his own personal piggy bank" (Green, 2009a). An IRS agent testified that from 2005-2007, Okun spent over $30 million on things including a divorce, jewelry, a $171,000 wedding, and a yacht (Green, 2009b). At the three week trial Edward Okun did not testify and the defense did not offer evidence. Rather, Okun's lawyers argued that Okun did not steal the money, he only "borrowed" it and intended to pay it back. The prosecutor countered with "These are not loans. They would be loans if the clients knew what was going on and agreed to it. They're thefts."(O'Dell, 2009)

Coleman, Field and Simring all cooperated with the prosecution and agreed to testify. Okun's first wife testified that his fraudulent behavior may have started way back in the 1970's when his sister and uncle sued him for improper business practices in Canada. Shortly after that he left Canada. A pivotal witness was Janet Dashiell, former owner of 1031 Advance Inc., one of Okun's QI companies. She recounted how she deposited money in a separate secret bank account so that Okun did not have access to it. Dashiell did this after an email exchange with Okun where she stated that the company was short on cash and that perhaps Okun really didn't need to purchase another airplane (Green, 2009b).

Okun was convicted of numerous counts of mail fraud, wire fraud and money laundering. The prosecution showed how funds were consistently transferred out of 1031TG and other QI companies into Okun's personal bank accounts.

Okun was also convicted of bulk cash smuggling. Okun instructed an IPofA employee to ship $15,000 in cash to his yacht in the Bahamas. He specifically asked the employee to cash two checks. According to the indictment, Okun sent an email to the IPofA employee saying "[C]could you please fed ex $15,000 cash (large bills and pad the package with paper on both sides so it looks like a thick document, you may want to put it in several envelopes so they can't tell what it is) to me here in nassau people don't like credit cards here. I would suggest cashing two checks one for 5,200 and one for 9,800 so you stay under the cash reporting with the IRS or better yet take someone else with you, you cash one and they cash the other…"

In the end, Okun was convicted of 23 counts including conspiracy to commit mail and wire fraud, wire fraud, conspiracy to commit money laundering, money laundering, bulk cash smuggling and perjury. He was sentenced to 100 years in prison and ordered to forfeit $40 million. Coleman, after cooperating with prosecutors, pleaded guilty to conspiracy to commit mail and wire fraud and perjury. She was sentenced to 10 years in prison and ordered to pay full restitution. Field pleaded guilty to conspiracy to commit mail fraud and money laundering and was sentenced to five years in prison and ordered to pay full restitution. Simring pleaded guilty to conspiracy to commit mail fraud and money laundering and was sentenced to three years in prison.

<u>The Victims</u>

The victims included a 56 year old Seattle woman who lost approximately $500,000 of her retirement. Another woman, 59, lost $335,000 after selling a house she had purchased with an inheritance from her sister. One family lost approximately $500,000 from the sale of a strip mall that had been in the family for decades. A Denver based 1031 Exchange Company is responsible for 65 claims with many claiming to be owed more than $1 million. The list goes on. In the end there were nearly 600 victims of the Okun's Ponzi scheme (Green, 2008).

One of the victims who lost $2 million in a real estate deal spearheaded a civil lawsuit against Wachovia Bank. The lawsuit contended that Wachovia overlooked the fraud while profiting from the management of the 1031 Tax Group accounts. The lawsuit stated that the bank should have been aware of the money laundering and the illegal transfers of funds from IPofS's bank account to 1031TG bank accounts. Wells Fargo agreed to a settlement of $45 million to be paid to plaintiffs as a result of work performed by Wachovia Corporation (acquired by Wells Fargo in 2008).

QUESTIONS

1. Are qualified intermediaries legitimate businesses?
2. Okun tried to avoid federal currency reporting requirements by instructing his employee to cash two checks: one for $5,200 and one for $9,800, so as to stay under the $10,000 cash reporting requirements and then ship the $15,000 cash to his personal yacht in the Bahamas. Briefly describe the federal currency reporting requirements and briefly describe the purpose of these requirements.
3. What is money laundering?
4. What is a Ponzi scheme?
5. How does the Okun case compare to other cases in the news lately?
6. What is the government doing to combat financial fraud?
7. What are the ethical issues in this case?

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TEACHING NOTES

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GENERAL COMMENTS

This case describes a real world fraud that went undetected by authorities for several years. By completing this case study, students can go beyond textbook learning and gain real insight into the ethical and legal issues associated with Ponzi schemes. Students will also learn about federal currency reporting requirements and certain aspects of the tax law. The case can help students develop both written and oral communication skills. This case is appropriate for an Ethics course, Introduction to Business course or a Fraud course. It can be used in an undergraduate or graduate level course. We typically assign the case as an individual project, allow one week for the students to complete the case questions, and spend one class period discussing the solutions on the day the case questions are due. It has been our experience that students find the case to be interesting, and lively classroom discussions often ensue. On average, each student's solutions take about 20 minutes to grade.

QUESTIONS

Question 1: Are qualified intermediaries legitimate businesses?

Solution 1: Most qualified intermediaries are legitimate businesses that act as safe keepers of funds so that investors can defer capital gains taxes when purchasing a similar type of property. Section 1031 of the tax code allows investors to legally defer this gain. Investors can only defer the gain if the proceeds from the sale of the property go directly into a QI. The QI then is responsible for keeping the funds until another property is purchased by the investor. At that time, the QI transfers the funds directly to the closing agent for the sale. A QI should help the investor make sure that the transaction complies with Section 1031 of the tax code.

Question 2: Okun tried to avoid federal currency reporting requirements by instructing his employee to cash two checks: one for $5,200 and one for $9,800, so as to stay under the $10,000 cash reporting requirements and then ship the $15,000 cash to his personal yacht in the Bahamas. Briefly describe the federal currency reporting requirements and briefly describe the purpose of these requirements.

Solution 2: The Bank Secrecy Act was passed in 1970. To comply with this act, financial institutions that engage in a currency transaction in excess of $10,000 must file a Currency Transaction Report (CTR) with the IRS. If Okun's employee had cashed one check for $15,000, this would have necessitated a CTR report from the bank. According to the IRS website, more than 15 million CTRs were filed in 2008. Financial institutions are also required to file a report when there is suspicious activity. If the bank knew or suspected that the employee was structuring transactions in order to avoid CTR reporting, then this would be considered suspicious activity and would trigger a report as well. The purpose is to detect and prevent money laundering, tax evasion, and other criminal activities. Reporting requirements are described in detail at www.irs.gov.

Question 3: What is money laundering?

Solution 3: Money laundering means to conceal the source of funds. It is usually done so that the money then can be used without incurring any legal penalties. It is estimated that between $300 billion and $1 trillion is laundered each year (Crumbley et al., 2009).

Question 4: What is a Ponzi scheme?

Solution 4: The Securities and Exchange Commission describes a Ponzi scheme as "an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, the fraudsters focus on attracting new money to make promised payments to earlier-stage investors and to use for personal expenses, instead of engaging in any legitimate investment activity."(from http://www.sec.gov/answers/ponzi.htm)

Ponzi schemes tend to unravel or collapse at some point because there are no new investors, so money runs out and the original investors cannot get their money.

Question 5: How does the Okun case compare to other cases in the news lately?

Solution 5: This question gives the instructor an excellent opportunity to discuss current stories that are in the news. Students will also likely bring up Charles Ponzi from the 1920's, for whom the Ponzi scheme was named. Charles Ponzi did not invent the Ponzi scheme, but his was the first to be well known in the United States.

The most famous Ponzi scheme in recent history was perpetuated by Bernie Madoff. Madoff's multi-billion dollar Ponzi scheme impacted thousands of investors, many of whom lost their life savings. The Madoff case is especially interesting because he was able to dupe not only individual investors, but also institutional investors and regulatory authorities for years. An important difference between the Madoff fraud and the Okun fraud is that with Madoff, the victims were *investing* their money and they knew that there was some level of risk. With Okun, clients were merely placing their funds in QIs for *safekeeping*, and it was assumed to be risk free.

Question 6: What is the government doing to combat financial fraud?

Solution 6: In November 2009, President Barak Obama signed an executive order which established a Financial Fraud Enforcement Task Force. The purpose of the task force is to investigate and prosecute financial crimes, recover ill-gotten gains, and to punish the perpetuators. The task force is comprised of members of the federal government and includes members from the Department of Justice, the FBI, the Department of the Treasury, the Department of Homeland Security, HUD, the IRS, the Secret Service, the SEC, and numerous other organizations.
According to the SEC website, in 2009 the SEC filed 60 enforcement actions involving Ponzi schemes or Ponzi-like payments.

Question 7: What are the ethical issues in this case?

Solution 7: Student answers to this question will vary and it is an excellent chance for lively classroom discussion. The number of victims in the Okun Ponzi scheme is estimated at 577. These victims placed their money in a qualified intermediary with the expectation that it would be there for them when they purchased their next property. Many victims lost their life savings. Okun's sentencing memorandum stated "Okun's criminal acts drove many individuals to economic collapse or near collapse, and caused especially significant noneconomic, emotional damage on many of his victims" (Green, 2009c). The sentencing judge said the "toll of human loss and suffering Mr. Okun's unbridled greed produced is enormous" (O'Dell, 2009b).

Another item to consider is that many of the victims who put their money in one of Okun's QIs were unable to purchase a replacement property because their money was gone. Capital gains taxes may be due if no replacement property was purchased (Vuong, 2009).

Victims may recover some of their money through bankruptcy court, but these victims have spent a lot of time and money on legal fees, they have suffered emotionally, and have had to delay retirement. And for what? So that Okun could buy another yacht, another jet, more jewelry, etc? It can be interesting to ask the students if they think it was worth the three years of living the high life in exchange for a 100 year prison sentence.

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BIOGRAPHY

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