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### New Era Bankruptcy

Holly N. Mancl

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*Help Me Help You – Or Help Me Help You to Help Me:  
A Brief Review an Analysis of the Foundation for New Era Philanthropy Ponzi Scheme*

Holly N. Mancl

“*The public deserves exactly what it gets, no more, no less.*”<sup>1</sup>

**I. Introduction**

If it takes two to tango, it takes plenty to Ponzi. Nearly one-fifth of Albanians invested in a “guaranteed” eight-fold return in three months.<sup>2</sup> More than ten million Russians invested in the MMM scheme.<sup>3</sup> Between 1995 and 1998, the United Kingdom’s Department of Trade and Industry exposed eighteen Ponzi-esqe operations.<sup>4</sup> Between 1985 and 1995, experts estimated that roughly \$750 million had been invested in Ponzi schemes.<sup>5</sup> In fact, “[h]onest citizens lose about \$40 billion in scams every year.”<sup>6</sup> As such, one may wonder, if these schemes are so commonplace, why do investors continually fall prey to the same old con?<sup>7</sup> Perhaps it’s simply a

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<sup>1</sup> This quote is attributed to Charles Ponzi. See Charles Stein, *Crimes of the Century The Ponzi Scheme; 1920 Swindler Left Victims, Imitators*, BOSTON GLOBE, Nov. 22, 1999, at A1 available at Lexis.

<sup>2</sup> Robert Allen & Marshall B. Romney, Lessons from New Era – Largest, Non-profit Ponzi Scheme Fraud Committed by Foundation for New Era Philanthropy Founder John G. Bennett, Jr. (1998), <[http://findarticles.com/p/articles/mi\\_m4153/is\\_5\\_55/ai\\_54240894](http://findarticles.com/p/articles/mi_m4153/is_5_55/ai_54240894)> (discussing the investment scandal in Albania); see also Stein, *supra* note 1 (“In the mid-1990s practically everyone in Albania poured money into a series of Ponzi-style investment plans. By one estimate, \$1 billion or 25% of the poor nation’s gross national product was funneled into the plans that promised high rates of interest and used new money to pay off early investors. When angry Albanians found out they had been duped, they rioted in the streets and threatened to bring down the government.”).

<sup>3</sup> Allen & Romney, *supra* note 2; see also Interview by Bob Edwards with Ron Chernow, Author and Business Historian, in NPR Studio (May 24, 1995) [hereinafter Chernow Interview] (noting that the MMM Company scheme appealed to many Rumanians and Russians because naivety and lack of sophistication regarding capitalism made investors gullible enough to believe that their money could be doubled in six months).

<sup>4</sup> Allen & Romney, *supra* note 2.

<sup>5</sup> *Id.*

<sup>6</sup> Patti S. Spencer, *Money for Nothing? Scams, Fraud, and Cons*, INTELLIGENCER JOURNAL, Feb. 17, 2003, at 1, available at 2003 WLNR 6944197.

<sup>7</sup> “Con” comes from the phrase “confidence game,” and generally requires that the perpetrator gains the trust and confidence of the victim. *Id.* (discussing the etymology of “con”).

part of the legacy that the infamous king of the pyramid scheme, Charles Ponzi, left behind.<sup>8</sup> The question remains: how is it that John G. Bennett, Jr. (hereinafter “Bennett”) convinced more than 1,100 donors and investors to participate in the biggest charity fraud in history?<sup>9</sup>

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<sup>8</sup> Stein, *supra* note 1 (“Charles Ponzi did something few other criminals – not Al Capone or Jesse James – could manage: He got his name attached to a crime.”). See generally Chernow Interview, *supra* note 3 (“Mr. Ponzi was a very imaginative Bostonian who, in 1919, came up with the ingenious idea that he would promise his friends and relatives and other credulous investors that if they gave Mr. Ponzi their money he would be able to, within six weeks, give them a 50 percent return on their money.”).

From 1919-1920, Charles Ponzi, an American immigrant from Italy, swindled investors by promising high rates of return for investing in his International Reply Coupon trade business. Allen & Romney, *supra* note 2; Stein, *supra*. Ponzi set up an office and named his operation the “Securities and Exchange Company.” Allen & Romney, *supra*. Ponzi explained that by trading vouchers purchased in a country with a weak currency for postage stamps in America, he could exchange the stamps for cash and turn a profit. *Id.* Ponzi’s promise to double investors’ contributions within 90 days—a 100% return—enabled him to convince 40,000 investors to deposit almost \$15 million within the eight-month duration of his scheme. *Id.* To many, these returns sounded too good to be true; but Ponzi had what many conmen are blessed with—the “gift of gab.” Stein, *supra*. Investors poured money into Ponzi’s business, hoping to achieve a substantially higher return on investment than offered by local banks, which offered a mere 5% annual return. *Id.*

Ponzi promptly provided returns to initial investors within 45 days, word spread, and people willingly invested more money. *Id.* As with all pyramid schemes, “you have to rob Peter to pay Paul, but eventually you run out of Pauls and the whole thing collapses.” *Id.*; see Chernow Interview, *supra* note 3 (“What happens in any Ponzi scheme is that eventually you run out of fresh suckers and the entire pyramid scheme collapses, which is exactly what happened in 1920.”) Ponzi paid the initial investors with the funds gathered from subsequent investors. Stein, *supra*. Beginning in the winter, Ponzi siphoned money for himself and was rich by spring. *Id.* “He bought fancy suits and took to carrying a cane and a gold-tipped cigarette holder. He bought an expensive car and hired a chauffeur. He brought his mother over from Italy and purchased a huge house in Lexington for his wife, Rose.” *Id.* In May 1920 alone, people invested \$442,000. *Id.* “By the summer he was taking in \$250,000 a day.” *Id.*

Skeptics began to wonder how Ponzi could afford to pay such high returns. *Id.* The Boston Post closely followed Ponzi and exposed his prior criminal record, which included prison-time in Canada for swindling. *Id.* When Ponzi’s public relations guy rolled over on him for an article in the Boston Post, Ponzi’s scheme came to an end. *Id.* Once the scheme ended, investigators discovered that Ponzi had \$7 million in liabilities and \$3 million in assets, with a mere \$30 worth of postage stamps. *Id.* When asked about his scam, Ponzi had little remorse; he stated: “[t]he public deserves exactly what it gets, no more, no less.” *Id.* Coincidentally, the Boston Post reporters who revealed the scam “deserved” a Pulitzer Prize. *Id.*

<sup>9</sup> Tony Carnes, *New Era’s Bennett to Prison*, CHRISTIANITY TODAY, Oct. 27, 1997, available at <http://www.ctlibrary.com/ct/1997/october27/7tc86a.html> (generally noting that New Era’s Operation is the largest charity fraud in history). “Nonprofit experts have made the comparisons to Jim Bakker’s PTL Club scandal in the late 1980s, but the New Era case entangled many more individuals and groups.” *Id.*

Jim and Tammy Faye Bakker are notorious in the televangelist fraud category. The couple hosted the PTL (Praise the Lord) Club television program. Richard N. Ostling, *Enterprising Evangelism*, TIME, Aug. 3, 1987, available at <http://www.time.com/time/printout/0,8816,965155,00.html>. Based in Charlotte, North Carolina, The PTL show quickly gained popularity and shortly after its inception, more than twelve million viewers tuned in weekly. *Id.* As their success continually grew, the Bakkers created their own television network and even opened an amusement park called Heritage USA in Fort Mill, South Carolina. *Id.* They solicited donations and investments for a 504-room “Grand Hotel” to be opened on the Heritage USA grounds. Robert A. Prentice, *Anatomy of a Fraud: Inside the Finances of the PTL Ministries*, AM. BUS. L.J. (1993), available at <http://www.allbusiness.com/legal/415178-1.html>. Mr. Bakker enticed investors by calling investors “lifetime partners” and telling everyone that their \$1,000 initial contribution would be rewarded with annual three night/four day stays at the Grand Hotel. *Id.* People were forced to act quickly because Bakker would accept only 25,000 lifetime partnerships. *Id.*

## I. Getting Back to the Basics

### a. Who is John G. Bennett, Jr.?

#### 1. The Formative Years

Born in 1937 to an alcoholic father and a homemaker mother, John G. Bennett, Jr. grew up with modest means in Olney, Pennsylvania.<sup>10</sup> John G. Bennett, Sr. worked as a part-time door-to-door insurance salesman and as a laundry-truck driver during the Great Depression.<sup>11</sup> Bennett

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In addition to selling lifetime partnerships at the Grand Hotel, Bakker also sought “partners” for the Towers Hotel, the Family Heritage Club, and the 1100 Partnership. *Id.* Contributors sent the evangelicals more than \$1 million in donations each week. Ostling, *supra*. However, even from the early days, investors were unlikely to see their expected returns. *See* Prentice, *supra*. “Each [of the partnerships] was oversold so that lifetime members found it virtually impossible to stay in the hotels.” *Id.*

Jim Bakker did, in fact, use some of the invested funds to develop the theme park and hotels, but he also lavishly splurged on his posh lifestyle. *Id.* The Bakkers and other employees at PTL received extraordinary salaries. *Id.* Between June 1986 and March 1987, “Jim Bakker received \$1.04 million in bonuses and Tammy received \$335,000 in bonuses.” *Id.* This amount does not take into consideration their regular salaries as PTL employees. *Id.* In fact, the Bakkers had “six luxurious homes, complete with gold plated bathroom fixtures, and [even an] air conditioned doghouse.” *Id.* Tammy Faye even spent \$590 on a shower curtain. *Id.*

However, things were not all golden shower curtains and fancy make-up for the Bakkers. *Id.* Apparently Jim had an affair with a church secretary, Ms. Jessica Hahn. *Id.* When she threatened to go public with her allegations, Bakker offered her hush money. *Id.* However, when a male aide of Bakker alleged that Bakker made homosexual advances towards him and made arrangements for homosexual rendezvous with other young males, hush money could no longer cover the scandals. *Id.* The Charlotte Observer published articles with the allegations and investigated Bakker’s business. *Id.* Upon investigation, many financial questions arose, and soon thereafter, Bakker’s scandal was exposed. *Id.* The government indicted Bakker of taking more than \$4 million from the PTL “trough” and convicted Bakker of twenty-four counts of mail and wire fraud. *Id.*; Todd C. Frankel, *Jim Bakker Dreams Big in Missouri*, SAINT LOUIS TODAY, Feb. 17, 2008, *available at* <http://www.stltoday.com/stltoday/news/stories.nsf/missouristateneews/story/041C935E03A6B97A862573F1001E00A5?OpenDocument?>. Bakker was sentenced to forty-five years in prison for his misdeeds. Frankel, *supra*. While imprisoned, Bakker wrote a book entitled *I Was Wrong*, in which he apologized to those donors he “took” in the PTL scam. *Id.* After serving five years, Bakker was released. *Id.*

Bakker currently lives in Branson, Missouri and hosts “The Jim Bakker Show.” *Id.* Perhaps most amazingly to this author is that The Jim Bakker Show is another televangelist program, and Bakker continues to solicit donations from charitable viewers. *See id.* However, luckily for contributors, this time Bakker is not in charge of the accounting. *Id.*

<sup>10</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9 (noting that Bennett’s father had a “penchant for cigars and whiskey”).

Olney is a small town in Philadelphia County, Pennsylvania with a population of about 70,000. United States Census Bureau, 2000 Census, *available at* <http://factfinder.census.gov/> (enter “Olney” into the location field box and choose “Pennsylvania” from the drop down list). It is typically considered a northern suburb of Philadelphia. *Id.*

<sup>11</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

was born into a Presbyterian family, and his church provided him with the means to rise above his impoverished upbringing by providing a \$3,500 interest-free loan so he could attend college.<sup>12</sup>

To support himself through college, Bennett worked at Philadelphia Municipal Airport for United Airlines as a reservations clerk.<sup>13</sup> After college, in 1963, he began teaching chemistry at Agnes Irwin School for Girls and began to foster his reputation as “a cultured, educated, and most important[ly, a] socially acceptable leader.”<sup>14</sup> From teaching, Bennett decided to return to school and enrolled at Temple University Medical School.<sup>15</sup> Bennett garnered a reputation as a hard worker, and classmate James P. Cain, currently a physician, opined that “[Bennett] relied on doggedness rather than a brilliance he didn’t possess.”<sup>16</sup> Despite his hard work, the rigors of medical school got the best of Bennett, and halfway through his first year he took a leave of absence for medical reasons.<sup>17</sup>

Bennett dropped out of medical school when drug use was on the rise in the nation and Philadelphia authorities were desperately searching for candidates to run drug abuse counseling centers.<sup>18</sup> Bennett had the perfect resume for the job—he had a teaching background, understood chemistry and drugs, and developed an authoritative, knowledgeable bedside manner while in

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<sup>12</sup> *Id.* Bennett attended First Presbyterian Church in Olney, Pennsylvania. *Id.*

<sup>13</sup> *Id.* (noting that “Bennett, to introduce an aura of glamour, told college classmates his assignment was to hire pretty stewardesses and provide special handling for celebrities”).

<sup>14</sup> *Id.* Agnes Irwin School for Girls is an all girls Kindergarten through Twelfth Grade school in Rosemont, Pennsylvania. The Agnes Irwin School ~ All-Girls Education, <http://www.agnesirwin.org/podium/default.aspx?t=21467> (last visited Apr. 8, 2008). This school prides itself on its top-notch education and its recognition as a leading educational institution. *See generally id.*

<sup>15</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>16</sup> *Id.* (“He adopted rigorous study habits, and his uninterrupted hours in the library earned him the nickname ‘Iron Butt.’”).

<sup>17</sup> *Id.* Bennett claimed that he left medical school because of Meniere’s disease, “a disorder causing ringing in the ears and vertigo.” *Id.* He never returned to medical school following his leave of absence. *Id.*

<sup>18</sup> *Id.*

medical school.<sup>19</sup> This transition from academia into drug-rehab center management marked the beginning of Bennett's career in the non-profit sector.

## 2. Bennett: The Philanthropist, The Fundraiser, & The Businessman

Bennett excelled at his job – “[w]ithin eight years, he had organized seven local centers for drug-abuse intervention and education” and “was recognized as the foremost program manager in the state [of Pennsylvania].”<sup>20</sup> His excellence garnered him respect and political influence within Philadelphia's philanthropic community.<sup>21</sup> Bennett quickly capitalized on his experience and created Nova Institute International, a company in which Bennett worked as a fundraising consultant for drug-rehab programs.<sup>22</sup> Shortly thereafter, Bennett took over fundraising efforts for a drug-counselor training program at the Medical College of Pennsylvania and numerous other organizations.<sup>23</sup> Compassion International of Colorado Springs also hired Bennett as a fundraiser

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<sup>19</sup> *Id.* While in medical school, Bennett took classes that assisted him in mastering a bedside manner that portrayed a controlled, knowledgeable demeanor. *Id.*

<sup>20</sup> *Id.*; see also *United States v. Bennett*, 9 F. Supp. 2d 513, 525 (E.D. Pa. 1998) (discussing Bennett's career in the drug abuse counseling sector); Thomas S. Giles, “*Double Your Money*” *Scam Burns Christian Groups*, CHRISTIANITY TODAY at 39 (June 19, 1995).

<sup>21</sup> Carnes, *New Era's Bennett to Prison*, *supra* note 9 (noting that Bennett gained such political influence that he was appointed to the Governor's Council on Drug and Alcohol Abuse); see also Steve Wulf, *Too Good to Be True*, TIME, May 29, 1995, at 34 available at GALE, Document No. A16981999 (“Cathryn Coate, executive director of the Greater Philadelphia Cultural Alliance, says, ‘The word on the street was that Bennett was a super credible man, impeccable. You'd hear things like, ‘Oh, I've known Bennett for 15 years.’ It's not like a bunch of quick-fix guys duped a bunch of bozos.”).

<sup>22</sup> Carnes, *New Era's Bennett to Prison*, *supra* note 9.

<sup>23</sup> *Id.* See generally *United States v. Bennett*, 9 F. Supp. 2d 513, 525 (E.D. Pa. 1998) (discussing Bennett's work as a financial consultant with “Teen Challenge”). Teen Challenge is an organization that focuses on assisting teenagers with their drug abuse problems. Teen Challenge, About Us, 2007, <http://teenchallengeusa.com/about.php> (last visited Apr. 8, 2008).

Although Bennett quickly gained a reputation for being organized and able to raise funds, his reputation was far from impeccable. Carnes, *supra*. In fact, Lawrence Snow, a psychiatrist at the Medical College of Pennsylvania, asserted, “Bennett was well-connected with local foundations and some wealthy individuals. . . . He was always talking about this person he knew or that foundation he might join, but after a couple of years, he quit. He raised little or no money.” *Id.* Shortly after Bennett resigned as the Medical College's fund-raising director, the fund-raising program ended. *Id.*

in 1979.<sup>24</sup> Bennett’s performance in this role was sub par.<sup>25</sup> In fact, “[d]espite Bennett’s written reports indicating success, Compassion was not receiving any money.”<sup>26</sup> Wally Erickson, former President and current board member of Compassion stated, “When I flew out there to confront him . . . he admitted that he’d been lying—turning in falsified reports. He said he was sorry.”<sup>27</sup> “Erickson says he prayed with Bennett but terminated the relationship.”<sup>28</sup>

Through his continuous networking and non-profit schmoozing, Bennett met numerous wealthy individuals and community leaders.<sup>29</sup> Charming them with his warm personality, Bennett took advantage of his networking connections to create new “charities.” By 1982, Bennett founded the Center for New Era Philanthropy, which was funded in large part by wealthy philanthropists.<sup>30</sup> However, Bennett’s money management skills left a bit to be desired, and soon his lack of accounting prowess began to show.

### 3. Financial Trouble on the Horizon

Shortly after its creation, Nova’s business began to face financial distress.<sup>31</sup> In fact:

Montgomery County records reveal an unfolding financial disaster marked by unpaid debts, outstanding business bills and tax liens. From 1981 to 1983, six federal tax liens were filed against Nova Institute or Bennett. United Airlines and the Pennsylvania Department of Revenue filed liens and secured judgments. In 1984,

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<sup>24</sup> Randy Frame, *The ‘Post-New Era’ Era: Ministries Band Together to Overcome Losses*, CHRISTIANITY TODAY, July 17, 1995, at 55.

<sup>25</sup> *See id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* Interestingly, Compassion International discussed whether to invest in New Era. *Id.* Erickson advised the charity against association with Bennett but did not “warn other organizations because ‘Mr. Bennett indicated he had undergone a spiritual conversion, so [Erickson] thought it was possible things had changed.’” *Id.* Erickson further opined that “[t]here is a thin line between stander and fair warning.” *Id.*

<sup>29</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>30</sup> *Id.* Although Bennett established the Center for New Era Philanthropy in the early stages of his philanthropic endeavors, this is a distinct entity from the Foundation for New Era Philanthropy that fronted the largest Ponzi scheme in charity history. *Id.*

<sup>31</sup> *Id.*

the IRS placed a lien against Bennett and his wife, Joyce, his childhood sweetheart, for \$29,250.<sup>32</sup>

In addition to his financial troubles, Bennett also encountered personal problems. In 1984, Bennett was involved in a severe car accident.<sup>33</sup> Desperate for help, Bennett turned to God.<sup>34</sup> Specifically, Bennett turned to Wayne, Pennsylvania's Church of the Savior.<sup>35</sup> Church members took care of Bennett; they helped satisfy the IRS lien and even brought food to the Bennett's home.<sup>36</sup> Once Bennett was back on his feet, he revived the Center for New Era Philanthropy and ventured into the for-profit sector with Human Service Systems.<sup>37</sup> Even during these early businesses, Bennett's accounting was sub-par, but no one brought the potential check-kiting to the forefront.<sup>38</sup>

In addition to running the Center for New Era Philanthropy and Human Service Systems, Bennett continued consulting and began training nonprofit personnel at Bell Telephone of

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<sup>32</sup> *Id.*

<sup>33</sup> *Id.*; *Man Accused in Charity Scheme Faces 82 Charges*, N.Y. TIMES, Sept. 28, 1996, available at <http://query.nytimes.com/gst/fullpage.html?res=9D04E0D6123CF93BA1575AC0A960958260> (noting that Bennett was in a car accident in 1984 causing brain damage for which he sought psychiatric treatment).

<sup>34</sup> Carnes, *New Era's Bennett to Prison*, *supra* note 9. Bennett claimed that his spiritual renewal was based, in some part, on God sparing his life in the car accident. *Id.*

<sup>35</sup> *Id.* Wayne, Pennsylvania is a charming town located in Delaware County near the Randor Township. Welcome to Wayne, Pennsylvania, <http://www.waynepa.com/> (last visited Apr. 9, 2008). Coincidentally for Bennett, the Church of the Saviour's membership was comprised of many of Wayne County's wealthy families. Carnes, *supra*. The Church describes itself with the following statement:

Church of the Saviour was started in 1972 by a few people that wanted to be a blessing to those on the Main Line. These men and women stepped out in faith and God began transforming their families and friendships through the message of Jesus Christ. Our church has grown and changed over the years. These years have shown us that we are people in need of God's love and that God is a faithful God who cares for us and the people around us. Our desire is that we will continue to walk in faith as those who have gone before us so that we would continue to see the love of God transforming us, our families and our friendships.

Church of the Saviour, <http://www.cosnet.org/> (last visited Apr. 8, 2008). This church began as a doctoral dissertation and currently has more than 2,200 members. Wikipedia, Church of the Saviour (Wayne, Pennsylvania), Feb. 24, 2008, [http://en.wikipedia.org/wiki/Church\\_of\\_the\\_Saviour,\\_Wayne](http://en.wikipedia.org/wiki/Church_of_the_Saviour,_Wayne) (last visited Apr. 8, 2008).

<sup>36</sup> Carnes, *New Era's Bennett to Prison*, *supra* note 9.

<sup>37</sup> *Id.* Human Service Systems "made mental-health service placements for employees of local businesses." *Id.*

<sup>38</sup> *Id.* (noting that "as early as 1987, questions emerged about possible illegal check writing").



Pennsylvania “on how to manage their operations more economically.”<sup>39</sup> Bennett used his position at Bell Telephone not only to network, but also to establish the Bell Institute for Nonprofit Excellence and sponsor community prayer breakfasts.<sup>40</sup> The “face-time” Bennett earned in this position raised his profile even more within Philadelphia’s philanthropic community.<sup>41</sup> Bennett’s ties enabled him to meet members of the Templeton family who supplied Bennett with the “seed money” to create the Templeton Institute for Nonprofit Excellence.<sup>42</sup> “The Templeton association marked the beginning of what Bennett unshakably believes he ha[d] been divinely called to accomplish: The contribution of his unique skills, insights, and gifts toward helping people help others, especially in money matters.”<sup>43</sup> Bennett then focused his attention on four goals: (1) “a ‘Kingdom Focus,’” (2) “meeting people’s needs,” (3) “eliminating pain and suffering,” and (4) “making dreams come true.”<sup>44</sup>

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<sup>39</sup> *Id.*

<sup>40</sup> *Id.* The Bell Institute of Nonprofit Excellence rewarded nonprofits that excel in their day-to-day activities. *Id.*

<sup>41</sup> *Id.* (“Bennett’s activities increasingly raised his profile among East Coast philanthropists and the nonprofit community, including the wealthy Templeton family.”); *see also* Wulf, *supra* note 21 (“Bennett became a popular and influential figure in Philadelphia’s philanthropic and cultural circles”).

<sup>42</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9. Bennett actually won over John M. Templeton, Jr., a well-known pediatric surgeon in Philadelphia. *Id.* Templeton is the son of the famous John Templeton, Sr. who was known as an investor and philanthropist. *Id.* In addition to charming the younger Templeton, by 1990, Bennett had convinced the elder Templeton of his endearing qualities, and Templeton, Sr. named Bennett a director of numerous mutual funds he controlled. *Id.* The Templeton Institute is basically an extension of the Bell Institute’s Program for Nonprofit Excellence. *Id.* Similarly to the Bell Institute, the Templeton Institute rewarded excellence in non-profit work. *Id.*

<sup>43</sup> *Id.* This type of encouragement seems like a classic “help me help you” enticement style. Such reasoning was used in the Blockbuster hit *Jerry Maguire* when Maguire (played by Tom Cruise) encourages Rod Tidwell (played by Cuba Gooding, Jr.) to join Maguire’s newly independent agency. *JERRY MAGUIRE* (Sony Pictures 1996). This type of reasoning also served as the name for an ABC sitcom series in fall 2006. Wikipedia, “Help Me Help You,” Mar. 21, 2008, [http://en.wikipedia.org/wiki/Help\\_Me\\_Help\\_You](http://en.wikipedia.org/wiki/Help_Me_Help_You) (last visited Apr. 10, 2008). “*Help Me Help You* was a comedy about a collection of eccentric individuals in group therapy with a respected therapist – who may quite possibly have more problems than his patients.” *Id.*

<sup>44</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9. Regardless of which “good works” Bennett was conducting, each of his endeavors fell under an “umbrella philosophy” that Bennett referred to as “Change the World for the Glory of God.” *United States v. Bennett*, 9 F. Supp. 2d 513, 525 (E.D. Pa. 1998) (“each organization he founded shared the four elements of his “Change the World” philosophy: first, that God have a significant influence on the activity, which defendant called a “Kingdom Focus”; second, that the activity “meet people’s needs”; third, that the activity be directed to “eliminate pain and suffering”; and fourth, that the activity help “make others’ dreams come true.”).

Driven by his four-part philosophy, Bennett established the Foundation for New Era Philanthropy (“New Era” or “Foundation”) in 1989 “to advise non-profits on management and fundraising techniques.”<sup>45</sup> Because New Era initially followed through on the projected returns, Bennett began to gain more acclaim among the charity circle and was even offered positions on numerous boards.<sup>46</sup> However, the skeletons in Bennett’s closet from his Nova Institute days of faulty accounting haunted his performance at New Era, and shortly after the Foundation began, New Era faced financial difficulty.<sup>47</sup>

## II. New Era’s Scam

The scam was simple. During its five and a half year operation, New Era managed to swindle more than \$135 million out of more than 1,100 charities and non-profit organizations until the scheme collapsed and the Foundation for New Era Philanthropy filed for bankruptcy protection.<sup>48</sup>

### 1. The Check Kite<sup>49</sup>

As previously mentioned, New Era was not Bennett’s first “business.”<sup>50</sup> In 1989, he was in charge of “several businesses that were having financial difficulty.”<sup>51</sup> By late August, he began

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<sup>45</sup> Allen & Romney, *supra* note 2; *see also* Carnes, *New Era’s Bennett to Prison*, *supra* note 9 (noting that the Foundation for New Era Philanthropy is the successor company to Center for New Era Philanthropy). *See generally* Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1491 (1998) (discussing New Era’s creation); Brief of Respondent-Appellee at \*7, *United States v. Bennett*, No. 97-1816 (3d Cir. Feb. 20, 1998) (“The heart of the scheme was Bennett’s operation of the Foundation for New Era Philanthropy [“New Era”]. Bennett began operating New Era as a ‘charitable organization’ in 1989.”).

<sup>46</sup> Allen & Romney, *supra* note 2.

<sup>47</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9 (discussing Bennett’s circumstances leading to the check kite); *see also* *United States v. Bennett*, 161 F.3d 171, 173 (3d Cir. 1998) (“In 1989, Bennett encountered financial difficulties in connection with several of his businesses.”).

<sup>48</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>49</sup> Black’s Law Dictionary defines “check-kiting” as: “The illegal practice of writing a check against a bank account with insufficient funds to cover the check, in the hope that the funds from a previously deposited check will reach the account before the bank debits the amount of the outstanding check.” BLACK’S LAW DICTIONARY 97 (2d pocket ed. 1996).

<sup>50</sup> *See supra* note 31-32 and accompanying text (discussing Bennett’s financial difficulty with Nova Institute).

transferring money between his Philadelphia National Bank accounts and his Merrill Lynch accounts.<sup>52</sup> Although he wrote checks from one account to deposit into another, these checks were based on insufficient funds.<sup>53</sup> These “transfers” created false balances in Bennett’s accounts, and by 1995, about 75% of the funds listed in Bennett’s Philadelphia National Bank and Merrill Lynch accounts were fictitious.<sup>54</sup> “Suspicious transfers” can catch up to a person, and by August 31, 1989, Philadelphia National Bank placed a hold on one of Bennett’s accounts.<sup>55</sup>

Bennett needed money, so he devised a plan and called it charity.<sup>56</sup> From September 5 through September 12, 1989, “Bennett contacted various individuals and asked them to participate in a program which would allegedly allow them to increase their charitable giving.”<sup>57</sup> Donors would deposit funds with New Era’s New Concepts Program, Bennett would control the money for a period of three months, an “anonymous donor” would double the original amount, and Bennett would send the doubled amount to a charity of the original donor’s choice.<sup>58</sup> Thus the

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<sup>51</sup> Brief of Respondent-Appellee, *supra* note 45, at \*8 (“Bennett encountered financial difficulties with several of his businesses”).

<sup>52</sup> *Id.*; Brief of Petitioner-Appellant at \*7, *United States v. Bennett*, No. 97-1816 (3d Cir. Feb. 20, 1998) (“[I]n 1989 the defendant engaged in a check kite.”); *see also* Carnes, *New Era’s Bennett to Prison*, *supra* note 9 (“By September 1989, Bennett had built up a fictitious \$466,133 in PNB accounts and another \$413,195 in Merrill Lynch accounts.”). Bennett had four accounts with Philadelphia National Bank and two accounts with Merrill Lynch. Brief of Appellee, *supra* note 45, at \*8.

<sup>53</sup> Brief of Appellee, *supra* note 45, at \*8 (“For instance, on September 8, 1989, Bennett wrote checks totaling \$47,500.00 on one of his PNB accounts, which he deposited into one of his accounts at Merrill Lynch. The subject PNB account had a balance of only \$100 at the time the checks were written and deposited.”) (internal citations omitted). *See generally* *United States v. Bennett*, 161 F.3d 171, 173 (3d Cir. 1998) (“As a consequence [of Bennett’s financial difficulties], he devised a check-kiting scheme using his bank accounts at Philadelphia National Bank and Merrill Lynch, writing checks from one account to another on insufficient funds and created false balances reflecting fictitious amounts.”).

<sup>54</sup> Brief of Appellee, *supra* note 45, at \*8 (“Bennett’s passing checks between the PNB and Merrill Lynch accounts created false balances in these accounts based on fictitious funds.”) (internal citations omitted).

<sup>55</sup> *Id.* at \*9; *see also* Carnes, *supra* note 9 (noting that “a PNB branch manager noticed a suspicious pattern of transfers between Bennett’s PNB accounts and two Merrill Lynch accounts, and the bank froze Bennett’s New Era Philanthropy account”).

<sup>56</sup> *See generally* Brief of Appellee, *supra* note 45, at \*8-9 (discussing the “big picture” of the New Era Ponzi scheme).

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*; *see also* *Bennett*, 161 F.3d at 173 (“Bennett told potential investors that a wealthy donor would match their contributions at the end of the holding period. The doubled funds would then be transferred to a charity of the

“New Concepts in Philanthropy Fund” program began, and Bennett received approximately \$65,000 in initial investments.<sup>59</sup> Rather than investing the money as promised, Bennett used the deposited funds to repay \$800,00 in debt owed to Philadelphia National Bank and Merrill Lynch from the check kite scam he designed to cover his indebted business accounts.<sup>60</sup>

## 2. The New Concepts Program<sup>61</sup>

The New Concepts in Philanthropy Program was the cornerstone of the Foundation for New Era Philanthropy.<sup>62</sup> According to New Era’s bankruptcy trustee, Arlin Adams, this Program attracted 99.4% of the funds deposited with New Era.<sup>63</sup> Here’s Bennett’s initial sales pitch:

An anonymous donor wants to encourage giving by offering to match charitable gifts to various organizations. To participate, wealthy individuals deposit their funds with New Era for a period of time. At the end of the holding period, the gift will be matched by the anonymous donor and the now doubled funds will be sent to the charity chosen by the original donor.<sup>64</sup>

Initially, only individuals could participate in the program.<sup>65</sup> However, as time went on, Bennett needed more money and became an equal opportunity scammer. The mandatory initial contribution amount increased from \$5,000 to \$25,000, and the required waiting period grew from

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donor’s choice.”); Carnes, *supra* note 9 (“Bennett, increasingly in desperate straits, . . . contact[ed] several friends to participate at a minimum of \$5,000 as ‘beneficiary donors’ with the pledge that their money would be doubled by an anonymous donor after three months.”).

<sup>59</sup> Brief of Appellee, *supra* note 45, at \*9

<sup>60</sup> *Id.* at \*7-8. Bennett used the first wave of money to “pay down the overdrafts of his business accounts at Merrill Lynch and the Philadelphia National Bank.” *Bennett*, 161 F.3d at 174 (noting that Bennett “routinely invaded the held funds to benefit his for-profit businesses”).

<sup>61</sup> In all, the Foundation for New Era Philanthropy had five programs: (1) the New Concepts in Philanthropy Program, (2) the Templeton Institute for Non-profit Excellence, (3) the Bennett Fellows Program, (4) the Evelyn Bennett Foundation, and (5) the Alan Ameche Foundation. Brief of Appellee, *supra* note 45, at \*9. The Templeton Institute for Non-Profit Excellence offered “training for religious non-profit organizations” in developing a board of directors and improving both fundraising and management and was sponsored largely by the Templeton family. *Id.* The Bennett Fellows program sponsored and trained youths in community service. *Id.* The Evelyn Bennett Foundation, named for Bennett’s mother, provided needy individuals with financial assistance. *Id.* Finally, the Alan Ameche Foundation assisted needy high school students in obtaining necessary tuition. *Id.*

<sup>62</sup> Brief of Appellee, *supra* note 45, at \*13.

<sup>63</sup> *Id.*

<sup>64</sup> *Bennett*, 161 F.3d at 173 n.1 (internal citations omitted).

<sup>65</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9; see also *Bennett*, 161 F.3d at 173 n.1 (describing Bennett’s sales pitch).

three, to six, to nine, or even ten months.<sup>66</sup> By 1993, Bennett expanded the program to allow non-profits to participate.<sup>67</sup> Eventually, Bennett sought donations from European and Asian investors.<sup>68</sup> In the matching funds program, the anonymous donors were key, and over time Bennett explained that the number of donors grew from one to nine over the five and a half year operation.<sup>69</sup> As the number of investors increased, the scam grew into a pyramid scheme.<sup>70</sup>

Bennett's initial investors expected returns by January 1990.<sup>71</sup> Luckily for Bennett, his for profit consulting firm received a \$250,000 payment from Bell Telephone around the same time.<sup>72</sup> This timely payment enabled Bennett to pay off his initial investors.<sup>73</sup> However, after this initial set of payments, "Bennett would use no more real money for real services but would keep afloat on the waves of money from the pyramid scheme."<sup>74</sup>

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<sup>66</sup> Carnes, *New Era's Bennett to Prison*, *supra* note 9.

<sup>67</sup> Brief of Appellee, *supra* note 45, at \*10; *see Bennett*, 161 F.3d at 174 ("Bennett expanded the program to allow nonprofit organizations to participate.").

<sup>68</sup> Brief of Appellee, *supra* note 45, at \*10.

<sup>69</sup> *Id.*; *see Carnes, New Era's Bennett to Prison*, *supra* note 9.

<sup>70</sup> *Bennett*, 161 F.3d at 174. *See generally* Carnes, *New Era's Bennett to Prison*, *supra* note 9 (discussing "The Pyramid Crows"). As Carnes explains in his article, "[Bennett] used four basic methods: expanding the base of participation, relaxing deposit restrictions, increasing the minimum contribution, and requiring a longer holding period in exchange for a greater payout." *Id.* Thus, once all factions were in place, Bennett created a pyramid scheme. *Id.*

Technically, pyramid and Ponzi schemes are not synonymous. *See* James Walsh, *How Ponzi Schemes, Pyramid Frauds Work*, CONSUMERS' RESEARCH MAGAZINE, June 1, 1999, at 10. The major difference is "in a Ponzi scheme, money is handed over to be invested; in a pyramid scheme, money is handed over in exchange for a right to do something (most often, to open a franchise or to solicit new members)." *Id.*

<sup>71</sup> Carnes, *New Era's Bennett to Prison*, *supra* note 9.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> *Id.* As more individuals invested, Bennett used the new investments for two purposes: (1) to "prop up" his other businesses and (2) to "match" previous donors' funds thereby perpetuating the Ponzi. Brief of Appellee, *supra* note 45, at \*7-8 ("New Era was, from the outset, a Ponzi scheme, with the deposits of new money being used to match (thereby doubling) the funds of the old depositors. Bennett, in fact, paid \$3.5 million from New Era to companies which he wholly owned and used another \$3.4 million of New Era money to prop up his other failing businesses."). *See generally In re M & L Business Machine Co., Inc.*, 84 F.3d 1330, 1332 n. 1 (10th Cir. 1996) (defining "Ponzi scheme" as "an investment scheme in which returns to investors are not financed through the success of the underlying business venture, but are taken from principal sums of newly attracted investments. Typically, investors are promised large returns for their investments. Initial investors are actually paid the promised returns, which attract additional investors."). As defined by Black's Law Dictionary, a Ponzi scheme is:

Throughout the five and a half years, many investors conducted some form of due diligence.<sup>75</sup> Bennett controlled these inquiries by only accepting new applicants who were “nominated” by previous donors, thereby creating an exclusive “inner circle.”<sup>76</sup> Bennett provided all investors with binders of information containing the details of the program.<sup>77</sup> These binders explained that the anonymous donors signed trust agreements pledging to match the charitable contributions,<sup>78</sup> Bennett received no salary,<sup>79</sup> New Era’s board of directors was comprised of “prominent individuals,”<sup>80</sup> deposits were held in escrow or “quasi-escrow” accounts at Prudential Securities in Kenosha, Wisconsin,<sup>81</sup> and New Era’s operating expenses were covered by the interest earned on deposits during the mandatory holding period.<sup>82</sup>

Bennett further corroborated his “binder of information” with false tax records filed with the Internal Revenue Service (“IRS”).<sup>83</sup> In an effort to “further enhance the organization’s

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A fraudulent investment scheme in which money contributed by later investors generates artificially high dividends for the original investors, whose example attracts even larger investments. Money from the new investors is used directly to repay or pay interest to earlier investors, usu. without any operation or revenue-producing activity other than the continual raising of new funds. This scheme takes its name from Charles Ponzi, who in the late 1920s was convicted for fraudulent schemes he conducted in Boston.

BLACK’S LAW DICTIONARY (8th ed. 2008).

<sup>75</sup> *Bennett*, 161 F.3d at 175 (discussing Bennett’s response to due diligence inquiries); *see, e.g.*, Susan Berger, *This Charity Scandal May Wind up Helping Donors Like You*, MONEY, July 1995, at 24 (“W. Todd Bassett, divisional commander of the Salvation Army in Eastern Pennsylvania and Delaware, says the regional board acted with due diligence. He told Money that although it initially rejected a request to invest in New Era, it approved the move after getting more financial information.”).

<sup>76</sup> *See generally* Carnes, *New Era’s Bennett to Prison*, *supra* note 9 (“Particularly after October 1993, New Era required lengthy application forms and a visit of the organization’s management to New Era headquarters.”).

<sup>77</sup> Brief of Appellee, *supra* note 45, at \*10.

<sup>78</sup> *Bennett*, 161 F.3d at 175; Brief of Appellee, *supra* note 45, at \*10-11.

<sup>79</sup> *Bennett*, 161 F.3d at 175; Brief of Appellee, *supra* note 45, at \*11.

<sup>80</sup> *Bennett*, 161 F.3d at 175; Brief of Appellee, *supra* note 45, at \*11.

<sup>81</sup> *Bennett*, 161 F.3d at 175; Brief of Appellee, *supra* note 45, at \*11.

<sup>82</sup> *Bennett*, 161 F.3d at 175; Brief of Appellee, *supra* note 45, at \*11; *see also* Brody, *supra* note 45, at 1491 (noting that using the interest generated from the funds invested during the short-term period, New Era would “generate income to defray operating expenses”).

<sup>83</sup> *See infra* notes 84-88 and accompanying text (discussing Bennett’s interactions with IRS actions).

standing and credibility,” New Era applied for tax-exempt status in 1993.<sup>84</sup> However, the IRS denied New Era’s request because the Foundation did not have a board of directors.<sup>85</sup> Not to be discouraged, Bennett drew up a fictitious board of directors and re-submitted the paperwork.<sup>86</sup> Bennett’s resubmitted paperwork, however, remained incomplete; he omitted the “matching funds” program because he was afraid that it would raise suspicions about the true nature of New Era’s business.<sup>87</sup> “When an IRS auditor came to New Era’s premises in 1994, Bennett shielded the official from the matching funds program and gleefully announced that New Era was so successful that it had no liabilities. In 1993, an audit review of New Era’s books claimed only minor liabilities and no obligations to repay funds.”<sup>88</sup>

By lying to both accountants for New Era and an IRS auditor, Bennett convinced the IRS to issue a “favorable audit letter” for New Era in 1994.<sup>89</sup> The falsified tax records showed that New Era was “a stable organization.”<sup>90</sup> “The organizations and individuals relied on these

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<sup>84</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>85</sup> *Id.* The tax code provides that nonprofit organizations may file for tax-exempt status. *See* I.R.C. § 501(c) (2006). Further, the code also requires that to obtain nonprofit or tax-exempt status, an organization must have a board of directors. *See generally* I.R.S. Pub. 557 (Mar. 2005), *available at* <http://www.irs.gov/publications/p557/ch03.html>.

<sup>86</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9; Brief of Appellee, *supra* note 45, at \*11.

<sup>87</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>88</sup> *Id.*; *see* Brief of Appellee, *supra* note 45, at \*11 (noting that New Era’s tax returns showed “virtually no liabilities” and that no matching funds obligations were listed).

<sup>89</sup> Brief of Appellee, *supra* note 45, at \*11-12 (“These documents did not show . . . liabilities because Bennett falsely told accountants for New Era that there were the matching funds owed at the end of each year. Similar representations were made to an auditor for the Internal Revenue Service.”) (internal citations omitted).

<sup>90</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

documents in their determinations to entrust New Era with their funds,”<sup>91</sup> and the funds available to Bennett grew.<sup>92</sup>

### 3. Bennett Strays from the Church

While Bennett became richer, he strayed from his church.<sup>93</sup> Rather than continuing the weekly fellowships and prayer breakfasts, Bennett focused his attention on his for-profit business ventures.<sup>94</sup> He increased his worldwide travel to such an extent that he became a “number one customer” with his travel agency.<sup>95</sup> Perhaps because he spent so much money on travel, Bennett even personally invested in the travel agency.<sup>96</sup> As one commentator noted:

It had become his practice to buy into companies doing business with his organization. Bennett would funnel business into a firm, creating a measure of dependence and indebtedness. Then he would buy into the firm to enhance his authority and control. Once in place, this pattern became a trademark of his operations. He later purchased interests in his accounting firm and Founder’s Bank.<sup>97</sup>

As he continued with his for-profit ventures, Bennett became blinded by the glitz and glamour of increased wealth.

### 4. Bennett’s Expansion of Money Making Ideas

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<sup>91</sup> Brief of Appellee, *supra* note 45, at \*11; *see also* Chernow Interview, *supra* note 3 (“One of the reasons that Mr. Bennett was able to get away with this was that the organization was set up in 1989. He didn’t file any income taxes until 1993. He had not registered with the State of Pennsylvania. If the organization had been fulfilling all of these registration and tax requirements, the scam would have been exposed sooner, although, frankly, I was really quite stunned in reading the audited statement of the organization, that these were people who had such a strong need and desire to believe that they didn’t exercise even the minimal level of vigilance.”).

<sup>92</sup> *See generally United States v. Bennett*, 161 F.3d 171, 175 (3d Cir. 1998) (“Having satisfied investors and auditors that New Era was a legitimate charity, Bennett then systematically transferred New Era funds to his struggling for-profit businesses through loan and stock purchases.”).

<sup>93</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>94</sup> *Id.*

<sup>95</sup> *Id.* Bennett was partial to using Bala Cynwyd Travel Agency, Main Line Travel Service for his travel arrangements.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*



As New Era continued to “prosper,” Bennett became more dependent on the inside “finders” to attract additional capital.<sup>98</sup> These “finders” or “intermediaries” would typically recruit new investors and nominate the organizations in exchange for a finder’s fee.<sup>99</sup> The finder’s fee was typically a percentage of the doubled contribution to the finder’s choice charity.<sup>100</sup> “This technique turned out to be a money machine for the intermediaries.”<sup>101</sup> However, when questioned, Bennett vehemently denied knowledge of the finder’s fee arrangement.<sup>102</sup>

In addition to utilizing finders to funnel money into his control, Bennett began transferring money from the New Era accounts to Human Services accounts and Multi Media Communications accounts.<sup>103</sup> Multi Media was a New York based publishing house that published Christian oriented books.<sup>104</sup> Bennett simply financed the publishing house with \$1.1 million of New Era funds.<sup>105</sup> Although Bennett did not technically control Multi Media, he played an important role in determining who was in charge of the publishing house.<sup>106</sup>

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<sup>98</sup> *Id.* Bennett referred to the groups of smaller contributions as “bundles.” *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* (“When questioned about the bundlers taking a percentage, Bennett has heatedly denied that he knew or approved of this practice.”).

<sup>103</sup> *Id.* Bennett also invested at least \$817,000 from New Era into his Health Services company. *Id.* Margaret Campolo explained that “[Bennett] had such a neat idea in Human Services . . . . Businesses could subscribe, and if one of their employees had a drug or alcohol problem, that person could go there and receive help without notifying the company.” *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.* Mutli Media was fairly small; the publishing house published “70 titles, including Billy Graham biographer William Martin’s book *My Prostate and Me*, detailing [Billy Graham’s] own bout with prostate cancer.” *Id.* Bennett originally tapped Jarrell McCracken, the founder of Word, Inc., as the president for the publishing house. *Id.* However, because of McCracken’s suspicions of “wrongdoing in company ranks,” McCracken was terminated, Richard W. Ohman took over the position, and Bennett became a “right-hand man” as the Multi Media Chair. *Id.* These controlling antics illustrate Bennett’s Type-A management style. These controlling features early in Bennett’s career foreshadow his management of New Era. In fact, the micro-management of New Era was one of the major warning signs that New Era investors seemed to ignore.

These various business ventures, at least around 1993, were paying off for Bennett.<sup>107</sup> In turn, Bennett was generous with his “earnings.”<sup>108</sup> He “reward[ed] his associates and intermediaries richly” and “finance[d] a posh lifestyle for his wife and their two daughters.”<sup>109</sup> Bennett liked to share in his “good fortune” so he brought friends into his ownership circle. He gave Tony and Margaret Campolo, his previous weekly fellowship partner and his partner’s wife, shares in Human Services.<sup>110</sup> Perhaps this generosity was easy for Bennett given that in 1993 alone, he controlled \$41 million in cash.<sup>111</sup>

## 5. Unraveling

When things sound too good to be true, they typically are. Any investment that guarantees a 100% return within a short time period sounds too good to be true. As every finance student is taught, without risk, there is no reward. Inversely, there is no reward without risk. Despite rare and occasional “digging” throughout the five and a half years of the New Era scheme, few paid attention the warning signs that were clearly in place.

### a. Cash Shortages

One of the early warning signs that many New Era employees noticed was simply that New Era seemed short on cash.<sup>112</sup> “New Era’s Mary Sinclair recalls the days when uncertainty and doubt dampened staff enthusiasm. Cash shortages were often blamed on late payments from

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<sup>107</sup> See generally *id.* (noting that Bennett’s “operation” was “running full throttle”).

<sup>108</sup> See generally *id.* (discussing Bennett’s rewards to his family and intermediaries).

<sup>109</sup> *Id.* Given how much money Bennett siphoned from New Era investors, he upgraded his lifestyle. In fact, he lived in a \$620,000 home that he paid for in cash, drove a Lexus, and even splurged on baseball tickets. See *Man Accused in Charity Scheme Faces 82 Charges*, *supra* note 33.

<sup>110</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* (discussing the “suspicious signs”)

clients, aggravated by Bennett’s policy of undercharging or sometimes even giving away services.”<sup>113</sup>

Tracy Ryan, Bennett’s chief assistant, remembers the sharp moments of anxiety early on in her employment with New Era. The cash shortage even reached the point where Ryan suspected the phone service would be cut off. Coworkers Jim Cummings and Bill Bennington say paychecks dribbled in on erratic schedules. At times, the explanation was that Bennett had simply forgotten to sign their checks.<sup>114</sup>

This seemed problematic given that New Era was receiving numerous cash deposits. However, these cash deposits were not being “matched” by anonymous donors and Bennett’s endless supply of money dwindled.

### **b. Demands for Disclosures & Paperwork Persist**

Throughout the process, Bennett discouraged employees, investors, and outsiders from asking questions.<sup>115</sup> In the “binders of information” supplied to potential donors, the literature warned organizations that if they asked questions that were not covered in the supplied binder, they would not be entitled to participate in the matching funds program.<sup>116</sup> Bennett also instructed Prudential employees to limit the information they gave to donors who called inquiring about their “New Era” accounts.<sup>117</sup>

As previously discussed, part of New Era’s early success was contingent on the fact that Bennett did not tell the “whole truth” when registering New Era with the IRS. By 1993, outsiders began to notice holes in the paperwork.<sup>118</sup> “In 1993, a whistleblower sent a letter to Mary Beth Osborn, head of the Charitable Trust Section of the Pennsylvania attorney general’s office, lighting

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<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* (discussing the “suspicious signs”).

a fuse that would eventually blow Bennett off his pedestal.”<sup>119</sup> Even though the organization started in 1989, New Era did not file tax returns or register as a charitable organization until 1993.<sup>120</sup>

Based on an outside complaint, a few months after New Era obtained a loan from Prudential in 1994, the IRS “sent an investigator to New Era’s premises for a field audit.”<sup>121</sup> “Bennett gave a federal agent fictitious minutes for December 1992 and December 1993 New Era board meetings. Bennett had dictated them to his secretary only the day before.”<sup>122</sup> However, given that Bennett continually fabricated records and lied to the federal investigator, New Era “passed” the audit, and Bennett demanded a letter from the IRS reflecting New Era’s status.<sup>123</sup> “With that letter in hand, Bennett then triumphantly displayed New Era’s clean bill of financial health to doubting donors and organizations.”<sup>124</sup>

Coincidentally, New Era’s external auditor with the firm John P. McCarthy & Co., Andrew Cunningham, began to ask questions concerning New Era’s accounting practices.<sup>125</sup> Around the same time, Cunningham expressed to Bennett that he needed \$50,000.<sup>126</sup> “In December 1994 and January 1995, Bennett ‘swayed the loyalty of Cunningham,’ in the words of federal attorneys, with

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<sup>119</sup> *Id.*

<sup>120</sup> Giles, *supra* note 20. Moreover, the organization failed to register with the State Bureau of Charities until 1993. *Id.*; see also Carnes, *New Era’s Bennett to Prison*, *supra* note 9. These greater financial disclosures were the “meat” that tipped Albert Meyer off to New Era’s scam. *Id.* As discussed in Part III.a., *infra*, Albert Meyer is the Spring Arbor College accounting professor who independently investigated New Era and alerted authorities and the Wall Street Journal about the Ponzi. *Id.*

<sup>121</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9. For a discussion of field audits, see Mervyn S. Gerson, et al., *Dealing with Tax Disputes*, HAW. B. J. (July 1998).

<sup>122</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*; *Man Accused in Charity Scheme Faces 82 Charges*, *supra* note 20.

<sup>126</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

payments totaling \$51,000.”<sup>127</sup> Bennett coupled the money with a suggestion to Cunningham to stop asking questions.<sup>128</sup> These oversights by both Prudential and Cunningham led to lawsuits against both parties.<sup>129</sup>

### **c. Bennett’s Business Sense (or lack thereof) Begins to Show**

By the mid-1990s, Bennett’s business ventures seemed reminiscent of the Nova Institute project.<sup>130</sup> “By 1994, Multi Media publishing was in financial disarray. Bennett loaned additional New Era moneys to Multi Media but moved administrative control to his own hands in Radnor. Also, Bennett purchased about \$1.8 million of Multi Media’s worthless stock, also using New Era money.”<sup>131</sup>

As New Era continued to fund Bennett’s other failing business ventures such as Multi Media, the Foundation fell deeper and deeper into financial distress.<sup>132</sup> By 1994, the matching funds program became problematic and Bennett needed new sources of money to pay the donors.<sup>133</sup> By the summer, Bennett drew a \$52 million loan from Prudential.<sup>134</sup> In addition to paying off previous investors and financially supporting failing businesses, Bennett siphoned money for himself and splurged on personal items, including a Lexus, baseball tickets, and a home

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<sup>127</sup> *Id.*; see *United States v. Bennett*, 9 F. Supp. 2d 513, 522 (E.D. Pa. 1998).

<sup>128</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>129</sup> See *infra* Part III.b.5 (discussing the case against Prudential); Part III.b.6 (discussing the case against Cunningham).

<sup>130</sup> See generally Carnes, *New Era’s Bennett to Prison*, *supra* note 9 (noting that Bennett began to face financial distress in 1994).

<sup>131</sup> *Id.*

<sup>132</sup> See generally *id.* (“Pyramid schemes demand an ever-accelerating cash flow.”).

<sup>133</sup> *United States v. Bennett*, 161 F.3d 171, 175 (3d Cir. 1998) (“By 1994, Bennett could no longer cover the ‘doubled’ funds solely through new donations.”); see also Brief of Appellee, *supra* note 45, at \*12 (“As in all Ponzi schemes, the need for new funds to repay old debts became greater the longer New Era remained in operation. When in 1994, the need for money to pay ‘doubled’ funds outstripped the infusion of new money, the defendant used a brokerage account at Prudential Securities . . . to obtain sufficient funds.”) (internal citations omitted); Carnes, *New Era’s Bennett to Prison*, *supra* note 9 (noting that “Bennett needed to broaden the donor base quickly and delay payout so that he could keep the operations afloat” and discussing New Era’s loan from Prudential “to keep the scheme afloat”).

<sup>134</sup> *United States v. Bennett*, 161 F.3d 171, 175 (3d Cir. 1998) (noting that Bennett secured a loan from Prudential based on treasury bills purchased with the depositors’ funds); Carnes, *New Era’s Bennett to Prison*, *supra* note 9; see Allen & Romney, *supra* note 2.

for his daughter.<sup>135</sup> Bennett told individuals and charitable organizations that their money was invested in treasury bills (“t-bills”) held in a Prudential account in Kenosha, Wisconsin, and donors who invested more than \$400,000 could double-check with Prudential that their funds were in escrow.<sup>136</sup> Bennett warned Prudential employees to limit the information it dispensed and to tell inquirers that money was in the escrow accounts when, in actuality, the t-bills simply served as collateral for the loan.<sup>137</sup> This loan provided New Era with enough capital to double depositors’ funds until New Era filed for bankruptcy protection in fall 1995.<sup>138</sup>

“In early 1995, Bennett and New Era reached their zenith. By the end of April, \$122 million surged in, sweeping Bennett to a breathtaking crest before a gigantic plunge. He cultivated some of America’s most wealthy family members, including Laurance Rockefeller, who agreed to serve on New Era’s board.”<sup>139</sup> The huge influx of investments during the first half of 1995 made Bennett desperate for additional income.<sup>140</sup> “Frantic for an ever-increasing flood of cash, Bennett altered the previous pledge of doubling money in six months to two and a half times your money in nine months.”<sup>141</sup>

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<sup>135</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9 (“More than \$354 million passed through New Era’s hands. Bennett siphoned off at least \$5 million for personal use and \$3 million for support of his for-profit companies, court documents reveal.”). By funneling contributions through his other companies, federal authority estimates indicate that Bennett had ultimately transferred \$3.5 million to himself. Allen & Romney, *supra* note 2.

<sup>136</sup> “Special care was given to organizations and individuals that deposited more than \$400,000. Bennett told these top donors that they could call the Prudential Securities office in Kenosha, Wisconsin, provide the staff with a code number, and the staff would inform the donor that a U.S. Treasury bill had been purchased on the donor’s behalf on a particular date.” Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>137</sup> *Bennett*, 161 F.3d at 175 (“Bennett told the organizations their money was being held in low-risk, interest-bearing accounts and escrow or ‘quasi-escrow’ accounts . . .”); *see also* Brief for Appellant, *supra* note 52, at \*10 (“Organizations and individuals were told that their money was held in Treasury Bills at the Prudential Securities office in Kenosha, Wisconsin, but were not told that the ‘quasi-escrow’ account[] . . . was really a margin account controlled by [Bennett] that frequently had a large debit balance.”).

<sup>138</sup> Brief of Appellee, *supra* note 45, at \*12; *see infra* Part III.b.2 (discussing the criminal case against Bennett).

<sup>139</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>140</sup> *Id.* This is because Ponzi schemes need an ever increasing cash flow to survive so first wave investors can be paid back with second wave investors’ contributions, then second wave investors can be paid back with third wave investors’ contributions, etc.

<sup>141</sup> *Id.*

### III. The Downfall

#### a. Albert Meyer

Albert Meyer was to John G. Bennett, Jr. what U.S. Treasury agent Eliot Ness was to Al Capone.<sup>142</sup> Though Bennett was by no means the head of an organized crime family, Bennett had constructed a scheme and covered his “tracks” with faulty paperwork. Capone also covered his tracks, but paperwork caught up to the notorious mafia boss.<sup>143</sup> Despite threats and constant fear that he might be “offed,” Ness pursued his target and eventually gathered enough information to charge Capone with tax evasion.<sup>144</sup> Though Meyer never feared for his life, Meyer, like Ness, pursued his target despite warnings to stop meddling. Just as Ness brought down a Capone’s crime family, Meyer brought down Bennett’s Ponzi.

Some may have thought of Albert Meyer as a hero; others thought of him as an “alarmist.”<sup>145</sup> Originally from South Africa, Albert Meyer began working as an associate accounting professor for Spring Arbor College in 1991.<sup>146</sup> “[H]e and his wife came in search of a

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<sup>142</sup> See Wikipedia, *Al Capone*, [http://en.wikipedia.org/wiki/Al\\_Capone](http://en.wikipedia.org/wiki/Al_Capone) (last visited Apr. 18, 2008). Although Capone is one of the most notorious gangsters in history, he was taken down for tax evasion. *Id.* He faced trial in 1931 on twenty-two counts of tax evasion. *Id.* Though Capone was only found guilty on five of the counts, the federal judge sentenced him to eleven years in prison. *Id.* Of those eleven years, Capone served six-and-a-half, before being released for good behavior. *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

<sup>145</sup> Giles, *supra* note 20.

<sup>146</sup> Wulf, *supra* note 21 (noting that Meyer is from South Africa); Paul Demery, *Accountant Blows Lid off New Era*, THE PRACTICAL ACCOUNTANT, 28 (July 1995) (noting that Meyer emigrated to America four years ago). While working as a professor, Meyer tried to instill ethics in his students. Albert Meyer, *Taking a Stand*, ACCOUNTANCY SA, Sept. 1, 2002, at 6, available at 2002 WL NR 5507374. In fact, he often gave students examples of what could go wrong if the accountants failed to serve the public rather than the individual whims of a client. *Id.* As Meyer explained in his article:

To illustrate my point, I used the following example. This was before the Enron debacle that for years to come will be held up as the poster child of audit failure. It's about Jose Gomez who had a bright future with Grant and Company, the tenth largest CPA firm in America at the time. Gomez was promoted to managing partner of the firm's Florida office while he was still in his early thirties. Unfortunately, he never realized [sic] his potential. Not many years after making managing partner, Gomez began serving a twelve-year term in a federal prison in Tallahassee, Florida, after pleading guilty to forgery and fraud. The story is too long and complicated to relay here, but suffice to say that

new cultural experience apart from the hectic pace of major U.S. cities.”<sup>147</sup> Though he found a job in the small town of Arbor, Michigan, Meyer was by no means secure in his position.<sup>148</sup> He came to the United States on a three-year working visa.<sup>149</sup> Because Spring Arbor was such a small institution, Meyer also kept the University’s books.<sup>150</sup> When Meyer noticed “a \$296,000 disbursement . . . to the Heritage of Values Foundation” he became skeptical.<sup>151</sup> He did not trust the name because “it reminded him of a similarly named theme park tied to a corrupt TV evangelist.”<sup>152</sup>

Based on his gut instincts, Meyer began to investigate the company.<sup>153</sup> First, Meyer looked through the University’s books.<sup>154</sup> Noting that the Heritage of Values Foundation was not included on the list of endowments, he began to ask questions.<sup>155</sup> Meyer explained, “I’m an accountant, I have to ask questions.”<sup>156</sup> University officials explained that the Heritage of Values Foundation was actually a part of New Era, but these explanations did little to quell Meyer’s apprehensions.<sup>157</sup> Further digging revealed that New Era was not actually registered as a

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Gomez succumbed to a series of ploys initiated by one of his audit clients, some very subtle psychological deceptions that spun a web of deceit out of which he could not extricate himself.

*Id.*

<sup>147</sup> Demery, *supra* note 146.

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* This is likely a reference to Jim Bakker’s PTL scandal in the early 1990s. For more of a discussion about Jim Bakker, see *supra* note 9.

<sup>153</sup> Wulf, *supra* note 21.

<sup>154</sup> Demery, *supra* note 20.

<sup>155</sup> *Id.*

<sup>156</sup> *Id.* In fact, Albert Meyer took this very seriously. In his article entitled, *Taking a Stand*, Meyer approvingly quoted a 1932 Fortune magazine article that stated, “Today it is no overstatement to say that there are three professions upon whose ethics, as well as upon whose skill, modern society depends: law, medicine, and Certified Public Accounting . . .” Meyer, *supra* note 146.

<sup>157</sup> Demery, *supra* note 146.



foundation.<sup>158</sup> Armed with his suspicions, Meyer requested New Era's return records from the IRS office in Philadelphia.<sup>159</sup>

Meyer voiced his concerns to the school's administration, but the administration was disinclined to listen to his warnings.<sup>160</sup> In fact, in an interview subsequent to New Era's downfall, Meyer stated, "I was told it's tough raising funds, and they didn't need my meddling."<sup>161</sup> Despite warnings from the school's administrators to stop digging, Meyer persisted on his quest to discover the underlying truth.<sup>162</sup> Meyer contacted Bennett directly.<sup>163</sup> Rather than being duped by a silver-tongued salesman, Meyer described Bennett as "bewildered and flustered" when asked about New Era's accounting practices.<sup>164</sup>

Following Meyer's conversation with Bennett, Bennett warned Spring Arbor to silence Meyer.<sup>165</sup> In fact, the President of Spring Arbor, Dr. Allen Carden, stated, "I know Albert Meyer, and his intentions are good. But I have communicated to Mr. Bennett that Albert's actions should in no way be interpreted as coming from Spring Arbor College."<sup>166</sup> For a short time these threats silenced Meyer, but once he secured a tenured position, he revamped his investigation of New Era.<sup>167</sup>

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<sup>158</sup> Wulf, *supra* note 21.

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* (quoting Albert Meyer); *see also* Giles, *supra* note 20 ("When Meyer voiced his concerns ... 'They said, 'You're biting the hand that feeds us...'").

<sup>162</sup> *See generally* Wulf, *supra* note 21 (discussing the break-down of the New Era Ponzi scheme).

<sup>163</sup> *Id.*

<sup>164</sup> *Id.* (quoting Meyer as saying "[h]e wasn't a smooth talker. There was an 'aw, shucks' atmosphere to it all. At the end of our conversation, when I put down the phone, I actually liked the guy").

<sup>165</sup> *Id.*

<sup>166</sup> Allen & Romney, *supra* note 2.

<sup>167</sup> *Id.*

By spring of 1995, coincidentally at the height of New Era's investments, Meyer began a "full-scale investigation" of New Era's finances and structure.<sup>168</sup> Meyer began by reviewing New Era's falsified 1993 tax returns.<sup>169</sup> "A careful look made it clear that New Era's numbers just didn't add up. [Meyer explained,] 'It treated what I thought were investments as gifts to New Era, so they were shown as revenues and he showed no liabilities. . . .'"<sup>170</sup> Meyer noted that New Era reported no "anonymous donor" contributions and showed a mere \$34,000 in earnings interest.<sup>171</sup> In fact, "[i]f New Era was holding up to \$10 million at any time, it should have run up \$600,000 to \$1 million in interest income," Meyer said. "But [Bennett] was not holding the money to earn interest. He had to pay it out because he was robbing Peter to pay Paul."<sup>172</sup> Armed with the falsified tax returns and desperate for someone to listen to his concerns, Meyer wrote letters to: (1) the IRS, (2) the Securities and Exchange Commission ("SEC"), (3) the U.S. Attorney General's office, and (4) the Wall Street Journal.<sup>173</sup> These letters played an integral role in bringing down the five and a half year Ponzi scheme.<sup>174</sup>

## **b. SEC Investigation**

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<sup>168</sup> *Id.*; see also Paul M. Clikeman, *Commentary of Arthur Andersen and Dan Rather*, PROVIDENCE JOURNAL, Oct. 11, 2004, available at 2004 WLNR 11559169 ("Accounting professor Albert J. Meyer, working alone on nights and weekends, exposed a \$200 million investment scam at the Foundation for New Era Philanthropy.").

<sup>169</sup> Allen & Romney, *supra* note 2.

<sup>170</sup> Demery, *supra* note 146.

<sup>171</sup> Allen & Romney, *supra* note 2.

<sup>172</sup> Demery, *supra* note 146; see also Allen & Romney, *supra* note 2 ("According to Meyer's calculations, the deposited funds should have generated as much as \$1 million in interest.").

<sup>173</sup> Allen & Romney, *supra* note 2; Wulf, *supra* note 21. Because of his bravery and diligence in pursuing the New Era pyramid scheme, Meyer received a job offer from Martin Capital Management, an Indiana based investment firm. Meyer, *supra* note 146. While employed at Martin, Bennett's watchdog tendencies continued, and he began investigating Coca-Cola Company's accounting practices. Wulf, *supra*. "Meyer claim[ed] that Coke is artificially boosting its results through transactions with a partly owned affiliate." *Id.* This position was not long-lived because Meyer "questioned" one of Martin's major clients. His investigation led Martin to fire Meyer. *Id.* Shortly after Meyer's dismissal from Martin, Meyer took a position working for Mr. Tice, who employs eleven financial analysts who publish newsletters containing recommendations for buying and selling stock. *Id.*

<sup>174</sup> Wulf, *supra* note 21.

Based on Meyer’s letter, the SEC began to investigate New Era.<sup>175</sup> Upon its lead, the SEC promptly notified Prudential of the investigation.<sup>176</sup> At the time of notification, Prudential held a New Era account with a balance of \$73 million.<sup>177</sup> As an article in *Time* magazine noted, “When Prudential examined the account, it came across one troubling aspect: those funds were used as collateral for a \$52 million loan.”<sup>178</sup> Next, “Prudential conducted a routine look at a New Era account in Kenosha, Wisconsin that held about \$60 million in T-bills. The firm became alarmed when it discovered New Era had borrowed \$52 million on margin and had repaid only \$7.1 million.”<sup>179</sup> Prudential asked New Era for company records, New Era’s attorneys refused, Bennett failed to account for \$44.9 million outstanding, and Prudential called the loan.<sup>180</sup> “On Friday, May 12, Prudential Securities liquidated \$44.9 million of T-bills in New Era’s account.”<sup>181</sup> As Bennett’s carefully constructed house of cards began to fall, the SEC charged Bennett with diverting “\$4.2 million into two firms he controlled personally.”<sup>182</sup>

### c. The Final Countdown

Perhaps it was the earlier phone call from Meyer or maybe it was Wall Street Journal writer Steve Stecklow’s investigatory journalism; but whatever the reason, by early May 1995, Bennett realized that New Era faced impending collapse.<sup>183</sup> On May 13, 1995, Bennett tearfully addressed

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<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> Allen & Romney, *supra* note 2.

<sup>180</sup> *Id.*; Wulf, *supra* note 21; see also “Voices’ Defense Denied in Fund Raising Fraud Case,” FUND RAISING MANAGEMENT, May 1997, at 28. (“Bennett’s grand scheme came to a collapse in May, 1995 when New Era failed to pay a creditor and was revealed as a paper enterprise with over \$135 million in debts and no assets or income.”).

<sup>181</sup> Allen & Romney, *supra* note 2.

<sup>182</sup> Wulf, *supra* note 21.

<sup>183</sup> *Id.*

his New Era employees, confessing, “I have betrayed you.”<sup>184</sup> Shortly thereafter, Bennett wrote a letter to his contributors that stated: “Those of you who know us, know we would never have done anything other than enable you to grow and flourish. My sole desire is to do everything possible to see that the obligations we have to you are fulfilled.”<sup>185</sup>

Although authorities exposing crimes may have been one problem Mr. Bennett faced, the Wall Street Journal exposure may have been even more problematic. When Stecklow contacted Bennett, Bennett knew that the New Era scandal would be publicly exposed.<sup>186</sup> On May 15, 1995, the Wall Street Journal cover story subtitle glared “Some Say Matching Grants by New Era Foundation Resemble Ponzi Scheme.”<sup>187</sup> By May 16, 1995, New Era’s luck had significantly changed.<sup>188</sup> Stecklow published a follow-up article entitled “Crumbling Pyramid: Owing \$500 Million, New Era Charity Seeks Refuge from Creditors: Mystery Donors Don’t Exist, Founder Tells His Staff; Colleges Face Big Losses – A Hard Blow to Good Works.”<sup>189</sup>

On the same day as publication of the first Wall Street Journal article, May 15, 1995, New Era filed for Chapter 11 bankruptcy protection.<sup>190</sup> In its petition, New Era cited \$551 million in liabilities and a mere \$80 million in assets.<sup>191</sup> When asked about his scheme, Bennett explained, “As the years passed by, the desire became a dream, the dream became a need, the need became an

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<sup>184</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>185</sup> Wulf, *supra* note 21; *Judge Orders Bankrupt Charity to Liquidate and Pay Creditors*, N.Y. TIMES, May 21, 1995, available at GALE Document No. A155432674 (“‘To have cause doubts, concern and pain to any of you is most distressing to me, to say the least,’ [Bennett] said.”).

<sup>186</sup> Allen & Romney, *supra* note 2.

<sup>187</sup> Steve Stecklow, *A Big Charity Faces Tough New Questions about Its Financing*, WALL ST. J., May 15, 1996, at A1, available at 1995 WL-WSJ 8711270. See generally Brody, *supra* note 45, at 1491 (discussing the effect of the Wall Street Journal article on New Era’s downfall).

<sup>188</sup> See Brody, *supra* note 45, at 1492 (discussing the Wall Street Journal’s follow up article).

<sup>189</sup> Steve Stecklow, *Crumbling Pyramid: Owing \$500 Million, New Era Charity Seeks Refuge from Creditors*, WALL ST. J., May 16, 1995, at A1, available at 1995 WL-WSJ 8711671. See generally Brody, *supra* note 45, at 1492 (discussing the article).

<sup>190</sup> Allen & Romney, *supra* note 2.

<sup>191</sup> *Id.* The New Era attorneys “explained that the total liabilities of \$551 million reflected the matching promises related to . . . outstanding funds [or those funds that had not yet been repaid].” *Id.*

obsession, the obsession became a fantasy, and the fantasy became a delusion.”<sup>192</sup> Soon after New Era filed for bankruptcy, Bennett was indicted for fraud, the SEC “accused New Era of selling unregistered securities and Bennett of diverting at least \$4.2 million from New Era donors to companies under his control,” and Prudential faced a class action lawsuit.<sup>193</sup>

#### **IV. Aftermath**

##### **a. Economic Aftermath**

The losses resulting from New Era’s scheme were catastrophic. Some Christian investors and charities lost faith in philanthropy.<sup>194</sup> Numerous institutions lost significant amounts of money.<sup>195</sup> Some organizations nearly collapsed.<sup>196</sup> Affecting more than 1,100 charities and non-profit organizations, New Era defrauded donors of more than \$135 million.<sup>197</sup>

##### **b. Court Proceedings**

Despite the enormous hardships and economic difficulties caused by New Era’s Ponzi scheme, John G. Bennett, Jr. went through the court proceedings fairly peacefully. Even though

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<sup>192</sup> See, e.g., Tony Carnes, *Bennett ‘Dream’ Became ‘Delusion,’* CHRISTIANITY TODAY, Oct. 27, 1997.

<sup>193</sup> Giles, *supra* note 20 (noting the SEC’s charge against Bennett); Wulf, *supra* note \_\_ (same).

<sup>194</sup> Carnes, “*Bennett ‘Dream’ Became ‘Delusion,’*” *supra* note 192 (“Bruce Johnson of Leighton Ford Ministries wrote that donor loss of trust and increased skepticism has been ‘tremendous.’”); David Neff, *How Shall We Then Give? Lessons from the New Era Debacle,* CHRISTIANITY TODAY, July 17, 1995 at 39 (“The net result has been an enormous loss of confidence.”).

<sup>195</sup> See, e.g., Neff, *supra* note 194 (“[M]any ... were tricked by the promise of quick infusions of capital. Some [organizations] even took out loans in order to deposit money with New Era. One institution, incredibly, ‘bet the farm,’ placing its entire endowment in New Era’s hands.”).

<sup>196</sup> See, e.g., Randy Frame, *New Era Settlement Seeks \$85 Million in Repayments,* CHRISTIANITY TODAY, Apr. 8, 1996, at 42 (“[A]t least one ministry is on the brink of collapse because of New Era. Chapel Ministries, based in Carol Stream, Illinois, has sold its two office buildings and laid off eight of its forty workers to stay afloat. Chapel Ministries ended fiscal 1995 with a \$700,000 loss.”); *Prudential Settles New Era Suit; Investors Eye Larger Payback,* CHRISTIANITY TODAY, Jan. 6, 1997, at 68 (“some organizations hurt by New Era are teetering on the edge of financial ruin”); Frame, *The ‘Post-New Era’ Era,* *supra* note 24 (noting following New Era’s collapse, the Chapel of Air Ministries “teetered on the brink of extinction”); Matt Miller, *Less than Nonprofit,* DAILY DEAL, Jan. 30, 2006, available at 2006 WLNR 2353664 (describing that the Chapel of the Air Ministries, Inc. heavily invested in New Era and thought about filing Chapter 7 after the debacle).

<sup>197</sup> Carnes, *New Era’s Bennett to Prison,* *supra* note 9; see also *Bennett*, 9 F. Supp. at 519 (noting that the loss was calculated to be in excess of \$100 million based on the undisputed evidence as to the amount owed investors when New Era collapsed).

the New Era Ponzi collapsed in 1995, New Era lived on in the courts for a few more years.

Numerous cases sprung from the scheme, including: (1) *In re Foundation for New Era Philanthropy*,<sup>198</sup> (2) *United States v. Bennett*,<sup>199</sup> (3) *SEC v. Bennett*,<sup>200</sup> (4) *Museum of Jewish History v. Bennett*,<sup>201</sup> (5) *Messiah College v. Prudential*,<sup>202</sup> and (6) *United States v. Cunningham*.<sup>203</sup> Although other suits tangentially related to New Era may have arisen, this paper discusses only the cases listed above that are directly related to New Era's collapse.

### 1. In re Foundation for New Era

New Era originally filed for Chapter 11 bankruptcy protection on May 15, 1995.<sup>204</sup>

Although Bennett initially hoped to reorganize New Era, when he realized that he no longer had the support of any charities, he voluntarily converted New Era's petition to a Chapter 7 filing on May 19, 1995, and the court appointed John T. Carroll III as interim trustee.<sup>205</sup> In its original petition, New Era listed a mere \$80 million in assets as compared to \$551 million in liabilities.<sup>206</sup> Through the incredible work of bankruptcy trustees John Carroll and Arlin Adams, much of the paid out funds were recovered and the overall loss was calculated as \$135 million.<sup>207</sup>

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<sup>198</sup> See *infra* Part IV.b.1.

<sup>199</sup> See *infra* Part IV.b.2.

<sup>200</sup> See *infra* Part IV.b.3.

<sup>201</sup> See *infra* Part IV.b.4.

<sup>202</sup> See *infra* Part IV.b.5.

<sup>203</sup> See *infra* Part IV.b.6.

<sup>204</sup> Carnes, *New Era's Bennett to Prison*, *supra* note 9.

<sup>205</sup> *Judge Orders Bankrupt Charity to Liquidate and Pay Creditors*, N.Y. TIMES, May 21, 1995, available at GALE Document No. A155432674 (discussing Bennett's decision to change New Era's petition from a Chapter 11 filing to a Chapter 7 filing); *Foundation for New Era Philanthropy Announces Filing for Voluntary Protection under Chapter 11*, P.R. NEWSWIRE, May 15, 1995, available at LEXIS (noting that New Era intended to file under Chapter 11).

<sup>206</sup> Karen W. Arenson, *Charity Group Charged in Fraud*, N.Y. TIMES, May 17, 1995, available at GALE Document No. A155427141. For a general discussion about the differences between Chapter 7 and Chapter 11 bankruptcy, see Ned W. Waxman & W. Homer Drake, Jr., *The New Practice under the Amended Bankruptcy Code*, 71 A.B.A.J. 55 (Feb. 1985).

<sup>207</sup> See Carnes, *New Era's Bennett to Prison*, *supra* note 9 ("The federal bankruptcy court has recovered more than 60 percent of the lost \$135 million and through negotiation and lawsuits is attempting to recover as much as 90 percent of the money. Bennett's assets of \$958,000 have also been used to reduce the losses.").

From the outset, the trustees sought reimbursement of monies actually paid to New Era donors.<sup>208</sup> Many charities voluntarily complied.<sup>209</sup> As Al Ciardi, a partner in the same law firm as Carroll, noted, “the charities feel morally directed to give back their ill-gotten gains.”<sup>210</sup> In addition to attempting to make the losers “whole,” the trustees sought to minimize litigation costs by encouraging settlement.<sup>211</sup> The trustees reasoned that this method would help minimize the overall loss.

Immediately upon appointment, Carroll began his investigation as to New Era’s assets and liabilities.<sup>212</sup> He enlisted the help not only of his law firm, Ciardi, Maschmeyer & Karalis, but also of Miller, Tate & Co., a forensic accounting firm.<sup>213</sup> With the help of both of these firms and information supplied from organizations involved, Carroll filed a Statement of Financial Affairs and Bankruptcy Schedules with the court on June 16, 1995.<sup>214</sup> However, Carroll’s service as trustee was short-lived.<sup>215</sup> “[Carroll] unified creditors against him when he notified them that he would oppose all their proofs of claim and notices of claim, evidently seeking to disqualify all or most

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<sup>208</sup> *New Era Philanthropy Bankruptcy Trustee Seeks Voluntary Return of Funds*, FINANCIAL NEWS, May 24, 1995, available at LEXIS (noting that Carroll initially requested that organizations voluntarily return funds).

<sup>209</sup> See generally *id.*

<sup>210</sup> *Id.*

<sup>211</sup> *Id.* (“Carroll said the ultimate intention is to recover the funds, while heading off any threat of litigation until the charitable organizations have a chance to meet.”).

<sup>212</sup> *New Era Trustee Files Statement of Financial Affairs and Bankruptcy Schedules; Filing Reflects Revised Numbers Based on ‘Net’ Calculations*, P.R. NEWSWIRE, June 16, 1995 available at LEXIS.

<sup>213</sup> *Id.* “Forensic accounting is the practice of utilizing accounting, auditing, and investigative skills to assist in legal matters.” Forensic Accounting Information, <http://www.forensic-accounting-information.com/> (last visited Apr. 10, 2008).

<sup>214</sup> *New Era Trustee Files Statement of Financial Affairs and Bankruptcy Schedules; Filing Reflects Revised Numbers Based on ‘Net’ Calculations*, *supra* note 212 (noting that “Carroll sent a letter to the more than 300 listed creditors seeking their cooperation in providing several documents, including records of cancelled checks, wire transfer confirmations, and any correspondence or memos between New Era and the creditor”). Carroll not only requested the correspondence and records, but he later requested that each creditor file a uniform “Proof of Claim” form with the court. *Id.*

<sup>215</sup> See generally Wendell L. Bird, *The Foundation for New Era Philanthropy Debacle: New Era Philandering*, BIRD & LOECHL, LLC, <http://www.birdlawfirm.com/newera.html> (last visited Apr. 18, 2008).

creditors from voting on a permanent trustee.”<sup>216</sup> The creditors then selected former Third Circuit Judge Arlin Adams to serve as trustee.<sup>217</sup> As the organizations involved began to understand the breadth of the situation, many banded together to make the best of a bad situation.

### a. United Response

Given the sheer number and the philanthropic undertones of investors, many came together following New Era’s bankruptcy announcement.<sup>218</sup> Many formed the group United Response “to share legal and financial resources and expertise to assist member organizations.”<sup>219</sup> Created by the Evangelical Council for Financial Accountability (“ECFA”),<sup>220</sup> United Response encouraged those who benefited from the scam to remit their earnings to the trustee to reimburse the “losers.”<sup>221</sup> Playing to the morals of the charitable organization “winners,” ECFA President Paul D. Nelson stated, “We’ve appealed to these groups to step forward voluntarily in a fashion that is biblically and morally correct [to understand] that the money they received did not come from anonymous donors, but from a sister charity.”<sup>222</sup> A combined effort of the organizations

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<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

<sup>218</sup> See Giles, *supra* note 20 (discussing the creation of United Response).

<sup>219</sup> *Id.*; see also *Prudential Settles New Era Suit; Investors Eye Larger Payback*, CHRISTIANITY TODAY, Jan. 6, 1997, at 68 (noting that United Response “attempted to address the crisis equitably and without expensive litigation”).

<sup>220</sup> Randy Frame, *New Era Bankruptcy Case Moves Toward Resolution*, CHRISTIANITY TODAY, Sept. 16, 1996, at 82; see also Berger, *supra* note 75, at 24 (describing ECFA as “a group of 800 Christian nonprofits”). See generally Frame, *The ‘Post-New Era’ Era: Ministries Band Together to Overcome Losses*, *supra* note 24 (describing United Response as “an effort coordinated by the [ECFA] to make the best out of the nightmarish circumstances resulting from the collapse of the Pennsylvania-based Foundation for New Era Philanthropy”).

<sup>221</sup> Maxwell, *supra* note 46. The number of participants in United Response changed over time. Compare Frame, *The ‘Post-New Era’ Era: Ministries Band Together to Overcome Losses*, *supra* note 24 (noting 153 member organizations as of July 17, 1995) with Frame, *New Era Settlement Seeks \$85 Million in Repayments*, *supra* note 196 (noting that United Response had 185 organizations as of Apr. 8); and Maxwell, *supra* note 46 (noting that United Response had 177 organizational members); and *Settlement Reached in New Era Case*, THE CHRISTIAN CENTURY, Oct. 16, 1996, at 959 available at GALE Document No. A18792649 (noting that United Response had 195 members as of October 1996).

<sup>222</sup> Frame, *New Era Settlement Seeks \$85 Million in Repayments*, *supra* note 196 (“Nelson’s appeal is based on the Golden Rule: ‘We’re asking organizations to treat others as they would like to be treated.’ He adds that even if no definite plan is in place, ‘we want organizations to step out in leadership and do the right thing.’”).



involved and Trustee Adams, United Response provided a cost effective alternative to litigation and encouraged “winners” to remit their “ill-gotten gains.”<sup>223</sup>

In addition to asking net profiting companies to remit their “winnings,” the trustee sought to settle with all parties involved.<sup>224</sup> The proposed settlement agreement took a largely economic approach to recovering funds paid to donors but also played to the philanthropic undertones.<sup>225</sup> The agreement called for Bennett to “turn over his \$620,000 house, car, stock holdings, retirement savings and other assets as well as the house of one of his daughters.”<sup>226</sup> The plan “require[d] the support of organizations representing at least 80 percent of the money lost to New Era. It also call[ed] for the endorsement of donors representing at least 80 percent of the amount given to New Era with the misguided expectation that their gifts would be doubled by the wealthy, and apparently nonexistent, anonymous donors.”<sup>227</sup> The proposed plan required those organizations that benefited from the scheme to return the proceeds within two months for distribution to those

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<sup>223</sup> *Id.* (“One of its goals is to achieve fair redistribution through negotiation, not through legal action.”).

<sup>224</sup> *Id.*

<sup>225</sup> See Frame, *New Era Bankruptcy Case Moves Toward Resolution*, *supra* note 220 (discussing the “Acts of Faith”). Many praised the “‘fair,’ ‘creative,’ and ‘landmark’” agreement Adams proposed to collect money that New Era paid to the “winners” of the Ponzi. *Id.* However, others criticized the seemingly cold approach given the Christian and philanthropic nature of the participants. See *id.* “‘United Response has taken a primarily economic approach to this case, and has neglected the opportunity for blessing involved by encouraging the open hand of stewardship and the sacrificial return of inappropriately gained profits.’” *Id.* (quoting Paul D. Nelson, President of the Evangelical Council for Financial Accountability); see also *Settlement Reached in New Era Case*, *supra* note 221 (quoting the Honorable Rollin A. Van Broekhoven, describing the settlement agreement as “a magnificent legal document, [that] also is driven by moral and religious motivation”).

<sup>226</sup> Frame, *New Era Bankruptcy Case Moves Toward Resolution*, *supra* note 220. An investigation into Bennett’s and New Era’s finances showed that Bennett used New Era funds to purchase a home for his daughter. *Id.*

<sup>227</sup> *Id.*

who lost money in the scheme.<sup>228</sup> At the time proposed, remission of funds would return an immediate \$39 million to the bankruptcy estate for redistribution.<sup>229</sup>

Nearly ninety percent of both donors and organizations supported the plan.<sup>230</sup> Some organizations readily returned their net profits.<sup>231</sup> However, asking those who made money to voluntarily give it up proved difficult for United Response.<sup>232</sup> Mercy Ships, an organization that “promote[s] health and well-being by serving the urgent surgical needs of the forgotten poor and empowering developing communities” netted \$3.5 million from New Era, and rather than initially giving up its profits, the ministry let the situation play out.<sup>233</sup> Those organizations that did not deposit with New Era and were given unsolicited money were also hesitant to return it or faced financial stress if they chose to return the gifts.<sup>234</sup> Accordingly, most of the “winners” chose to “wait and see” what ground rules were established before voluntarily returning money to the estate.<sup>235</sup>

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<sup>228</sup> *Id.* Although the plan seemingly called for return of all “net positive” payments, the agreement was not worded as such. *Id.* “The agreement encourages ‘net positive’ organizations to give back the full 100 percent. But it requires payment of just 65 percent, and less than that in cases of financial hardship. Thus, in theory, the plan allows for some organizations, in the end, to gain from New Era 35 percent or more of what they put in, while others stand to lose 35 percent.” *Id.*

<sup>229</sup> *Id.*

<sup>230</sup> *Id.* (“While most of the more than 180 evangelical schools and Christian organizations [were] solidly behind the United Response, support [was] not unanimous.”).

<sup>231</sup> See, e.g., Frame, *New Era Settlement Seeks \$85 Million in Repayments*, *supra* note 196 (“Baptists for Life is among a handful of organizations that have voluntarily relinquished New Era profits to the bankruptcy trustee.”).

<sup>232</sup> See generally *id.* (“Many organizations profiting from New Era spent the money and are unable or unwilling to pay it back. Some organizations have contended that they accepted money from New Era in good faith and feel under no obligation to return it.”).

<sup>233</sup> Mercy Ships, <http://www.mercyships.org/site/c.ehKHI0PJlqE/b.2733647/> (last visited Apr. 8, 2008); see Maxwell, *supra* note 46 (discussing Mercy Ships’ hesitance to voluntarily remit funds to New Era prior to a final settlement).

<sup>234</sup> See Frame, *The ‘Post-New Era’ Era: Ministries Band Together to Overcome Losses*, *supra* note 24 (“The Arlington, Virginia based Enterprise Development International, for example, invested no money with New Era but received – and spent – more than \$156,000 in unsolicited grants. President Robert Hancock says that the organization is committed ‘on moral and biblical grounds’ to repay the grants, ‘even though it puts our organization in jeopardy.’”).

<sup>235</sup> Frame, *New Era Settlement Seeks \$85 Million in Repayments*, *supra* note 196 (“[T]he majority of ‘net positive’ organizations are playing the waiting game. Wanting to make sure they are not the only ones to return the money. . . .”).

The proposed plan also called for Prudential to return the money it received as repayment of its loan to the estate.<sup>236</sup> Prudential opposed the plan, and the trustee filed suit against the securities firm for “giving credibility to New Era despite evidence of problems.”<sup>237</sup> The following subsection discusses the proceeding that arose when Prudential sought indemnification for the trustee’s claims against it.

**b. In re Foundation for New Era Philanthropy v. Prudential Securities, Inc., et al., 201 B.R. 382 (B.R. E.D. Pa. 1996).**

“On June 26, 1996, the chapter 7 trustee, Arlin M. Adams, filed an adversary proceeding against defendant Prudential Securities, Inc.”<sup>238</sup> In his 34-count complaint, the trustee alleged that Prudential received and benefited from numerous “fraudulent conveyances” as defined by 11 U.S.C. § 548(a)(1).<sup>239</sup> The complaint also alleged that Prudential “knew, or should have known, or

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<sup>236</sup> See generally *In re Foundation for New Era Philanthropy v. Prudential Securities, Inc., et al.*, 201 B.R. 382 (E.D. Pa. 1996) (proceeding concerning Prudential’s opposition to the trustee’s proposed plan); Part IV.b.1.b. (discussing the same).

<sup>237</sup> Frame, *New Era Bankruptcy Case Moves Toward Resolution*, *supra* note 220.

<sup>238</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 384.

<sup>239</sup> *Id.* This provision states:

(a)(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily--

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(B)

(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)

(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured ; or

had a reasonable basis to suspect that the debtor was operating a pyramid scheme and misrepresenting the nature of its commercial relationship with [New Era] to third parties.”<sup>240</sup> The

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(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

11 U.S.C. § 548(a)(1) (2005).

For a recent case involving the fraudulent conveyance provision during a Ponzi scheme case, see *Bayou Superfund, LLC v. WAM Long/Short Fund II, L.P.* (In re Bayou Group, LLC), 362 B.R. 624, 630 (Bankr. D.N.Y. 2007). The *Bayou Superfund* case states:

This provision, like analogous provisions under state law, avoids the entire amount of "any transfer" which was made by the transferor with actual intent to hinder, delay or defraud creditors. Moreover, the entirety of the transfer is avoidable whether or not the debtor received value in exchange, and the plaintiff need not allege and prove that the transfer was for less than fair value if actual intent is alleged and proved under Section 548(a)(1)(A). See *Sharp Int'l Corp. v. State Street Bank and Trust Co.* (In re Sharp Int'l Corp.), 403 F.3d 43, 56 (2d Cir. 2005) (citing *United States v. McCombs*, 30 F.3d 310, 328 (2d Cir. 1994)) ("[W]here actual intent to defraud creditors is proven, the conveyance will be set aside regardless of the adequacy of consideration given.") (applying the actual fraudulent conveyance provision of the DCL); see also *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir. 1995), *reh'g en banc denied*, 1995 U.S. App. LEXIS 17088 (7th Cir. 1995), *cert. denied sub nom. African Enterprise, Inc. v. Scholes*, 516 U.S. 1028 (1995) (under analogous Illinois fraudulent conveyance statute, "if fraudulent intent is proved, then . . . the defendant, unless he had no knowledge of the transferor's fraudulent intent must return the entire payment that he received rather than just the amount by which it exceeded the consideration that he gave in exchange for the payment"); *Hayes v. Palm Seedlings Partners-A* (In re Agric. Research and Tech. Group, Inc.), 916 F.2d 528, 538 (9th Cir. 1990) (under Section 548(a)(1)(A), "the entire transfer may be avoided, even if reasonably equivalent value was given, so long as the transferor actually intended to hinder, delay or defraud its creditors and the transferee accepted the transfer without good faith"); *Kendall v. Turner* (In re Turner), 335 B.R. 140, 145 (Bankr. N.D. Cal. 2005), modified on reconsideration by, 345 B.R. 674 (Bankr. N.D. Cal. 2006) ("the entire transfer is avoided" under Section 548(a)(1)(A) of the Bankruptcy Code); 5 Collier on Bankruptcy P 548.01 [1] at 548-11 (15th ed. 2006) ("[I]f the transaction is fraudulent within the rules set forth in section 548, the trustee may avoid it in its entirety without any limitation on the extent of the recovery other than those imposed by § 548(c) to protect transferees and obligees in good faith." (footnote omitted)).

*In re Bayou Group, LLC*, 362 B.R. at 630.

For an in-depth analysis of the fraudulent conveyance provision in light of a Ponzi scheme, see Mark A. McDermott, *Ponzi Schemes and the Law of Fraudulent and Preferential Transfers*, 72 AM. BANKR. L.J. 157 (1998). Mr. McDermott concludes:

In sum, courts recently have established that if a trustee proves the existence of a Ponzi scheme and that a particular person actually invested in the scheme and received payments from the debtor as a result of those investments, then the trustee is entitled to key presumptions in his favor in any fraudulent or preferential transfer action against the investor. Both the debtor's actual intent to defraud as well as its insolvency normally will be presumed. The investor will not be able to keep any fictitious profits which he received and will be unable to assert the ordinary course defense in any preference action. Perhaps most importantly, the investor will have to pay to the estate any amounts representing a return of his principal investments in any action for intentional fraud if he fails to carry the burden of proving that he received the transfers in objective good faith.

*Id.* at 186-87.

<sup>240</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 384.

trustee asserted that because Prudential gained “excessive profits” in its participation of the Ponzi, Prudential should return the money it received from the contracts and forego any litigation rights it may have had for the pre-petition loan.<sup>241</sup> In addition, the trustee asserted that any claim Prudential may have against New Era be subordinated to claims of other creditors, given Prudential’s participation in the scheme.<sup>242</sup>

In response, Prudential asserted that it did not and should not have known about New Era’s Ponzi scheme.<sup>243</sup> Prudential explained that it merely made loans to New Era, New Era secured the loans, the loans were repaid in full, and *others* actually benefited from the scam.<sup>244</sup> Because Prudential asserted that the loans were properly repaid, Prudential filed third-party complaints against Bennett and New Era claiming indemnification.<sup>245</sup> Prudential also asserted a third-party claim for indemnification against thirty-nine entities that received proceeds from Prudential as a result of New Era’s scam.<sup>246</sup> Prudential argued that requiring it to pay rather than

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<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> *Id.*

<sup>244</sup> *Id.*

<sup>245</sup> *Id.* (“PSI alleges that this third-party defendant [Bennett] made misrepresentations and false statements to PSI’s employees in order to hide his operation of a pyramid scheme. PSI contends that, to the extent the trustee succeeds in recovering the payment of loan proceeds made to PSI, PSI relied upon these material misrepresentations made by Mr. Bennett to its detriment.”).

<sup>246</sup> *Id.* Interestingly, forty parties were listed on the complaint rather than thirty-nine. *Id.* Bankruptcy Judge Bruce Fox pointed this discrepancy out in his opinion, but chose to refer to the thirty-nine entities because Prudential had done so in its pleadings. *Id.* These entities include: Dartmouth College, Princeton University, University of Pennsylvania, Amelior Charitable Fund, Balch Institute, Brandywine YMCA, Chattanooga Christian School, Citivision, Conservative Baptist Foreign Mission Society (CB International), Detroit Institute of Arts, English Language Institute of China, Ephrata Community Hospital Foundation, Focus, Frankford Hospital, Freedom Baptists Schools, Fuller Foundation, Gordon College, Gordon-Conwell Theological Seminary, Heal the World Foundation, J.S. Herr Foundation, Jesus Film Project, The Johnson Foundation, Kim College, Laity Lodge Foundation, Lan-Chester Christian School, Lancaster Christian School, Leadership Network, Maranatha Endowment Fund, The Mariposa Foundation, National Constitution Center, National Coalition Against Pornography, P.R.O. Missions, Peace Valley Church, Pennsylvania Academy of Fine Arts, Presbyterian Children’s Village, Sim, U.S.A., Spring Arbor College, and United World Mission. *Id.* at 382.

the entities who received payment would provide those entities with unjust enrichment.<sup>247</sup> Accordingly, Prudential sought indemnification.<sup>248</sup> Prudential filed both of these third-party complaints in the bankruptcy court asserting that the court had jurisdiction because (1) the claim “relate[d] to” the original bankruptcy case and (2) 28 U.S.C. § 1367 granted supplemental jurisdiction.<sup>249</sup>

The trustee filed a motion to strike Prudential’s third-party complaints asserting that the claims violated Fed. R. Bankr. P. 7014, or in the alternative, that the third-party actions should be severed from New Era’s bankruptcy proceeding.<sup>250</sup> Prior to discussing the trustee’s motion to sever the complaints, Judge Fox addressed *sua sponte* whether the bankruptcy court had subject matter jurisdiction over the third-party complaints.<sup>251</sup> As such, he first addressed jurisdiction as a related proceeding and then addressed possible supplemental jurisdiction.<sup>252</sup>

### 1. “Related” Proceedings

Judge Fox explained that three categories of proceedings arise in the bankruptcy context: (1) core bankruptcy proceedings, (2) non-core related proceedings, and (3) non-core unrelated proceedings.<sup>253</sup> The bankruptcy court may both hear and resolve core proceedings.<sup>254</sup> As for

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<sup>247</sup> *Id.* “Unjust enrichment is defined as the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience. Unjust enrichment describes a recovery for the value of the benefit retained when there is no contractual relationship, but when, on the grounds of fairness and justice, the law compels the performance of a legal and moral duty to pay.” 66 AM. JUR. 2D *Restitution and Implied Contracts* § 9 (2007).

<sup>248</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 384

<sup>249</sup> *Id.*

<sup>250</sup> *Id.* at 385. Fed. R. Bankr. P. 7014 simply incorporates Fed. R. Civ. P. 14 into bankruptcy proceedings. *See* FED. R. BANKR. P. 7014. Fed. R. Civ. P. 14 governs third-party practice and when a party may bring supplemental claims against a third-party defendant. FED. R. CIV. P. 14.

<sup>251</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 385 (noting that if the court does not have subject matter jurisdiction over the claims, then the trustee’s motion to sever the third-party complaints would be moot).

<sup>252</sup> *Id.*

<sup>253</sup> *Id.*

<sup>254</sup> *Id.* (citing 28 U.S.C. § 157(b)(1)). This provision states: “Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11 . . . .” 28 U.S.C. § 157(b)(1) (2008).

non-core related proceedings, the bankruptcy court “may hear and submit proposed findings of fact and conclusions to the district court.”<sup>255</sup> The bankruptcy court does not have jurisdiction to hear non-core unrelated proceedings.<sup>256</sup> Thus, the bankruptcy court’s jurisdiction may extend to a non-core proceeding that is “related to” the original bankruptcy case, but no further.<sup>257</sup> A supplemental case is “related to” the original proceeding when “*the outcome of [the supplemental] proceeding could conceivably have any effect on the estate being administered in bankruptcy. . . .* An action is related to bankruptcy if the outcome could alter the debtor’s rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.”<sup>258</sup>

Nearly all of the parties involved agreed that the proceedings were non-core, but disagreements arose regarding whether they were “related” proceedings.<sup>259</sup> “[T]he outer boundary

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<sup>255</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 385 (citing U.S.C. § 157(c)(1)). This provision states: “A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge’s proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.” 28 U.S.C. § 157(c)(1) (2008).

<sup>256</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 385 (citing *In re M. Paoella & Sons, Inc.*, 85 Bankr. 956, 969 (Bankr. E.D. Pa. 1988); *In re Bowling Green Truss, Inc.*, 53 Bankr. 391 (Bankr. W. D. Ky. 1985)) (emphasis in original).

<sup>257</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 384 (“[t]he outermost parameter of bankruptcy jurisdiction is defined by the concept of a related or non-core proceeding”).

<sup>258</sup> *Id.* at 386 (quoting *Pacor, Inc. v. Higgins*, 734 F.2d 984, 994 (3d Cir. 1984)).

<sup>259</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 386. The court noted that whether the proceedings were characterized as “core” or “related to” had little effect on the court’s ability to hear the case. *Id.* The only major difference in the two classifications is that the court lack’s the power to enter final judgment without the parties consent in a “related to” proceeding. *Id.*; see also *Matter of Walker v. Cradle Co.*, 51 F.3d 562, 568-69 (5th Cir. 1995) (discussing the jurisdictional limitations imposed upon the bankruptcy court); *Matter of Wood*, 825 F.2d 90, 93 (5th Cir. 1987) (same).

Obviously, Prudential and the trustee disagreed as to whether the third-party complaints were related proceedings. Most of the named parties played passive roles in this proceeding, but Presbyterian Children’s Village took the position that the third-party complaint proceedings were core proceedings. *In re Foundation for New Era Philanthropy*, 201 B.R. at 387. Presbyterian Children’s Village argued that Prudential simply tried to get around the Bankruptcy Code’s transfer avoidance provision. *Id.* For an extensive discussion on the avoidance provision, see Veryl Victoria Miles, *A Debtor’s Right to Avoid Liens against Exempt Property under Section 522 of the Bankruptcy Code: Meaningless or Meaningful?*, 65 AM. BANKR. L.J. 117 (1991). Presbyterian Children’s Village argued that allowing Prudential to collect from the third-party defendants on a state law claim of indemnification would violate the

of bankruptcy court jurisdiction is defined by those disputes whose outcomes ‘could conceivably have any effect on the estate being administered in bankruptcy.’”<sup>260</sup> Thus, if the outcome could not affect the bankruptcy proceeding, it is not within the bankruptcy court’s jurisdiction.<sup>261</sup>

Oftentimes, issues that arise between creditors may affect the bankruptcy proceeding.<sup>262</sup> The effect of creditors’ proceedings often differs based on what type of bankruptcy the debtor filed.<sup>263</sup> For example, the identification of a creditor will have little effect on a chapter 7 bankruptcy proceeding because all of the debtor’s assets are being liquidated.<sup>264</sup> Typically, when a creditor and a debtor are involved in a subsequent proceeding, the dispute will usually fall within

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Supremacy Clause of the Constitution because it directly conflicted with the provisions of the Bankruptcy Code. *In re Foundation for New Era Philanthropy*, 201 B.R. at 387.

Judge Fox found Presbyterian Children’s Village’s reasoning “unpersuasive” because core proceedings invoke a substantive right that must be decided by a bankruptcy court. *Id.* Prudential’s indemnification claims were deeply rooted in state law remedies and were not bankruptcy issues. *Id.* As such, the indemnification proceedings could not be “core” bankruptcy proceedings. *Id.* Judge Fox also noted that Presbyterian Children’s Village’s reasoning was faulty because it “imply[d] that a proceeding may be classified as core even if its outcome would have no conceivable effect upon the administration of a bankruptcy case.” *Id.*

<sup>260</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 387 (citing *In re Guild and Gallery Plus, Inc.*, 72 F.3d 1171, 1181 (3d Cir. 1996); *Matter of Lemco Gypsun, Inc.*, 910 F.2d 784, 788 (11th Cir. 1990)).

<sup>261</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 389 (citing *see, e.g., Pettibone Corp. v. Easley*, 935 F.2d 120 (7th Cir. 1991) (request by the chapter 11 debtor to enjoin a tort suit against it after confirmation was outside bankruptcy jurisdiction as such relief was not necessary for the consummation of the plan); *In re Haws*, 158 Bankr. 965, 971 (Bankr. S.D.Tex. 1993) (despite section 541 of the Code, an adversary proceeding brought by the chapter 11 trustee postconfirmation was dismissed as outside bankruptcy jurisdiction because any damages the trustee would recover would not be distributed to creditors under the terms of the confirmed plan); *In re Greenley Energy Holdings of Pennsylvania, Inc.*, 110 Bankr. 173, 184 (Bankr. E.D.Pa. 1990) (Scholl, B.J.) (adversary proceeding seeking an interpretation of a confirmed chapter 11 plan was dismissed due to lack of jurisdiction, even though 11 U.S.C. § 1142 grants the bankruptcy court power over disputes regarding the implementation of a confirmed plan, because its outcome would not affect the debtor’s reorganization); *In re Malone*, 74 Bankr. 315 (Bankr. E.D.Pa. 1987), recommendation approved, C.A. No. 86-361 (E.D.Pa., Sept. 30, 1987) (Fullam, D.J.) (proof of claim litigation could not be resolved by the bankruptcy court because it would have no conceivable effect upon the estate)).

<sup>262</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 390.

<sup>263</sup> *Id.*; *see, e.g., In re M. Paoella & Sons, Inc.*, 85 Bankr. 956, 969 (Bankr. E.D. Pa. 1988). *See generally* *Matter of Xonics, Inc.*, 813 F.2d 127 (7th Cir. 1987). “Other times, the outcome of the dispute will affect only the rights of the creditors inter se without making any difference in the bankruptcy case itself.” *In re Foundation for New Era Philanthropy*, 201 B.R. at 390; (citing *see, e.g., Matter of Walker*, 51 F.3d 562, 569 (5th Cir. 1995); *In re Fietz*, 852 F.2d 455 (9th Cir. 1988); *Matter of Kubly*, 818 F.2d 643 (7th Cir. 1987); *In re Pettibone Corp.*, 135 Bankr. 847 (Bankr. N.D.Ill. 1992); *In re Haug*, 19 Bankr. 223 (Bankr. D.Or. 1982)).

<sup>264</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 390 (“For instance, the relative priority of liens may be of significance in a chapter 7 case where the collateral is being liquidated. However, if the collateral were not to be administered by the chapter 7 trustee (usually because there is no equity in the property), then the relative position of the lien creditors may make no difference to the administration of that bankruptcy case. The priority question will matter greatly to the creditors upon foreclosure, but that dispute can and must be resolved in a non-bankruptcy forum when it arises.”).



the bankruptcy court's jurisdiction because the outcome of the subsequent proceeding may either increase or decrease the size of the debtor's estate.<sup>265</sup> However, third-party claims that do not involve the debtor or the trustee likely will not affect the bankruptcy proceeding.<sup>266</sup> When neither the estate nor the original proceedings will be affected, then "judicial economy alone cannot justify a court's finding jurisdiction over an otherwise unrelated suit."<sup>267</sup>

The trustee's claim against Prudential related to the original bankruptcy proceeding because prevailing on its claim against Prudential could increase the size of the debtor's estate.<sup>268</sup> On the other hand, Prudential simply sought indemnity from the third-party defendants *if* the trustee prevailed.<sup>269</sup> Prudential's claims against the third-party defendants would not affect on the size of the estate<sup>270</sup> because Prudential simply sought indemnification from the third-party defendants if it was held liable.<sup>271</sup> Indemnification claims typically fall outside of the bankruptcy court's jurisdiction.<sup>272</sup> In this case, Prudential did not claim that the effect of the third-party claim will

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<sup>265</sup> *Id.* ("Third-party complaints which involve the debtor or bankruptcy trustee, either as a third-party plaintiff or third-party defendant, will often have an effect upon the administration of a bankruptcy case because the outcome could affect the size of the estate (if the trustee succeeds as a third-party plaintiff) or could affect the amount of claims asserted against the estate (if the trustee does not prevail as a third-party defendant).")

<sup>266</sup> *Id.*; (citing *see, e.g.*, *Matter of Zale Corp.*, 62 F.3d 746, 753 (5th Cir. 1995); *accord* *Matter of Walker*, 51 F.3d at 569).

<sup>267</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 390 (quoting *Matter of Zale Corp.*, 62 F.3d 746, 753-54 (5th Cir. 1995)).

<sup>268</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 391.

<sup>269</sup> *Id.*

<sup>270</sup> *Id.* ("PSI's success or failure as third-party plaintiff will not enhance the funds in the bankruptcy estate available for distribution by the chapter 7 trustee.")

<sup>271</sup> *Id.* ("Indemnification differs from contribution. As explained by the Third Circuit: 'Indemnification and contribution differ in the extent to which a tortfeasor is able to rid himself of liability. Where the entire liability shifts, indemnification is invoked; on the other hand, where liability is shifted only proportionately, contribution exists instead.'") (quoting *De Laval Turbine, Inc. v. West Indiana Indus., Inc.*, 502 F.2d 259, 271 n.17 (3d Cir. 1974)).

<sup>272</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 384 (citing *E.g.* *Matter of Walker*; *Matter of Schwamb*, 169 Bankr. 601, 604 (E.D. La. 1994), *affirmed without op.*, 48 F.3d 530 (5th Cir.), *cert. denied sub nom.* *Delta Airlines, Inc. v. National Union Fire Ins. Co. of Pittsburgh*, 515 U.S. 1131 (1995); *In re Spaulding & Co.*, 131 Bankr. 84, 88 (N.D. Ill. 1990); *In re Remington Development Group, Inc.*, 180 Bankr. 365 (Bankr. D. R.I. 1995); *In re Summitt Airlines, Inc.*; *In re Pettibone Corp.*, 135 Bankr. at 850 ("Bankruptcy Judges frequently lack 'related to' jurisdiction to hear third-party complaints which arise from Adversary proceedings"); *In re K & R Mining, Inc.*, 135 Bankr. 269 (Bankr. N.D. Ohio 1991) (holding that there was no bankruptcy subject matter jurisdiction over a cross-claim); *In re Blava In-Line, Inc.*, 133 Bankr. 33 (Bankr. S.D.N.Y. 1991); *In re German*, 97 Bankr. 373, 375 (Bankr. S.D. Ohio 1989); *In re Kaiser Steel*

change the size of the bankruptcy estate, but rather that Prudential's claim would affect the *administration* of the case because it affects the number of claims against the estate.<sup>273</sup>

Prudential based its position on the notion that the third-party claims were related to the proceedings because they may affect the administration of the case was based upon § 502(h) of the Bankruptcy Code.<sup>274</sup> Prudential alleged that the trustee sought to “avoid various transfers of loan

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Corp., 95 Bankr. 782, 791 (Bankr. D.Colo.), *aff'd on other gnds*, 109 Bankr. 968 (D.Colo. 1989); In re Maislin Industries, U.S., Inc., 75 Bankr. 170, 172 (Bankr. E.D. Mich. 1987); In re John Peterson Motors, Inc., 56 Bankr. 588, 591 (Bankr. D. Minn. 1986); *see also* In re Fietz, 852 F.2d at 458; In re Houghton, 164 Bankr. 146 (Bankr. W.D.Wash. 1994). Compare In re Leco Enterprises, Inc., 144 Bankr. 244, 247, 250 (S.D.N.Y. 1992) (third-party complaint was related because the bankruptcy estate would, by agreement, recover a percentage of all sums recovered by the third-party plaintiff).

<sup>273</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 392. *See generally* In re Salem Mills, Inc., 148 Bankr. 505 (Bankr. N.D.Ill. 1992) (holding that a third-party claim was related to a bankruptcy case because its outcome would increase the amount of claims asserted against the estate).

<sup>274</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 392-93.

Section 502(h) provides:

(h) A claim arising from the recovery of property under section 522, 550, or 553 of this title [11 USCS § 522, 550, or 553] shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(i) A claim that does not arise until after the commencement of the case for a tax entitled to priority under section 507(a)(8) of this title [11 USCS § 507(a)(8)] shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(j) A claim that has been allowed or disallowed may be reconsidered for cause. A reconsidered claim may be allowed or disallowed according to the equities of the case. Reconsideration of a claim under this subsection does not affect the validity of any payment or transfer from the estate made to a holder of an allowed claim on account of such allowed claim that is not reconsidered, but if a reconsidered claim is allowed and is of the same class as such holder's claim, such holder may not receive any additional payment or transfer from the estate on account of such holder's allowed claim until the holder of such reconsidered and allowed claim receives payment on account of such claim proportionate in value to that already received by such other holder. This subsection does not alter or modify the trustee's right to recover from a creditor any excess payment or transfer made to such creditor.

11 U.S.C.S. § 502(h) (2005). Typically, a Chapter 13 debtor is allowed to discharge obligations upon payment of the same if the debtor “(1) certifies . . . that all domestic support obligations that came due prior to making such certification have been paid; (2) has not received a discharge in a prior case filed within a certain time frame . . . ;” and (3) “has completed an approved course in financial management. . . .” Chapter 13 Bankruptcy Basics, THE FEDERAL JUDICIARY, <http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html> (last visited Apr. 18, 2008).

payments made by the debtor to [Prudential].”<sup>275</sup> “[I]f the trustee were to recover avoidable transfers from [Prudential], the trustee [would] also seek to preclude [Prudential] from asserting any claims against the estate or to subordinate those allowable claims.”<sup>276</sup>

Prudential based its indemnification claims on a theory of unjust enrichment.<sup>277</sup> Prudential argued that the thirty-nine entities would be unjustly enriched if Prudential were forced to pay.<sup>278</sup> “If [Prudential] is denied any allowable claims against the estate, or if such claims are subordinated, that result would only occur if the trustee were to prove misconduct by [Prudential] that rises to the level of ‘very substantial’ misconduct involving ‘moral turpitude or some breach of duty or some misrepresentation whereby other creditors were deceived to their damage’ or as gross misconduct amounting to fraud, overreaching or spoliation.”<sup>279</sup> Thus, both of Prudential’s arguments were based on Prudential being found liable.<sup>280</sup>

Regardless of the subrogation, the amount of a claim on behalf of the estate would remain the same.<sup>281</sup> The amount of the trustee’s claim would remain the same whether Prudential paid,

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Section 502(h) simply describes certain discharges that may be disallowed. *Id.* Several other cases address the fraudulent conveyance provision within a similar factual setting involving a Ponzi scheme. *See, e.g.,* *In re M&L Business Machine Co., Inc.*, 160 B.R. 851 (1993); *In re International Loan Network*, 160 B.R. 1 (1993); *In re Mark Benskin & Co., Inc.*, 161 B.R. 644 (1993); *In re United Energy Corp.*, 944 F.2d 589 (9th Cir. 1991); *In re Independent Clearing House Co.*, 77 B.R. 843 (1987).

<sup>275</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 392.

<sup>276</sup> *Id.*

<sup>277</sup> *Id.*

<sup>278</sup> *Id.*

<sup>279</sup> *Id.* (quoting *In re M. Paolella & Sons, Inc.*, 161 Bankr. 107, 119 (E.D. Pa. 1993) (quoting *In re Osborne*, 42 Bankr. 988, 996 (W.D. Wis. 1984))).

<sup>280</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 394.

<sup>281</sup> *Id.* at 395.

Bennett paid, or one of the thirty-nine entities paid.<sup>282</sup> As such, the identity of the liable party was irrelevant because it would not affect the administration of a chapter 7 proceeding.<sup>283</sup>

Although Prudential argued that the identification of the party would affect the proceeding of the case and was thus “related to” the original case, Prudential mistakenly relied upon chapter 11 precedent rather than chapter 7 precedent.<sup>284</sup> Chapter 11 cases involve placing creditors into appropriate classes, some of which have more power in approving the reorganization plan than others.<sup>285</sup> Chapter 7 cases, on the other hand, do not have creditor classifications or voting by creditors.<sup>286</sup> Thus, even though a creditor’s identity may matter in chapter 11 cases, that is not the case in chapter 7 liquidation cases.<sup>287</sup> Because Prudential’s identification as a potential creditor is irrelevant, the third-party claims were not “related to” the original bankruptcy filing for jurisdictional purposes.<sup>288</sup>

## 2. Supplemental Jurisdiction

Next, Judge Fox addressed whether supplemental jurisdiction existed over Prudential’s third-party claims.<sup>289</sup> Supplemental jurisdiction exists over a claim if the subsequent claim is so related to the original case that it is part of the “same case or controversy.”<sup>290</sup> Although bankruptcy courts are split regarding whether bankruptcy courts may exercise supplemental

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<sup>282</sup> *Id.*

<sup>283</sup> *Id.* (“The only difference will be in the identity of the claimant, but the identity of the claimant is immaterial in a chapter 7 liquidation case such as this one.”).

<sup>284</sup> *Id.*

<sup>285</sup> *Id.* at 396. *See generally* 11 U.S.C. § 1122 (2005) (noting the classifications of claims); 11 U.S.C. § 1126 (noting the procedure to be followed in accepting a reorganization plan).

<sup>286</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 396.

<sup>287</sup> *Id.* at 397.

<sup>288</sup> *Id.* (“Therefore, I conclude that the third-party complaints are not ‘related to’ the chapter 7 bankruptcy case of this debtor, in that their outcome will not affect the administration of the case in any manner.”).

<sup>289</sup> *Id.* at 397-99.

<sup>290</sup> *Id.* at 397 (citing 28 U.S.C. § 1367).

jurisdiction over a claim, Judge Fox explained that the statute does not give the bankruptcy court the power to hear unrelated cases.<sup>291</sup> He asserted that the statutory provision grants only the district courts the power of supplemental jurisdiction and such jurisdiction “should be recognized as but one of a number of statutory grants of subject matter jurisdiction issued by Congress to the district courts.”<sup>292</sup> In fact, bankruptcy courts are specifically limited to core and related proceedings.<sup>293</sup> “If a proceeding is unrelated to the bankruptcy case, the district court has no authority to refer it to a bankruptcy judge – even if the proceeding falls within some other federal jurisdictional grant.”<sup>294</sup>

### 3. Ancillary Jurisdiction

Lastly, Judge Fox explained that ancillary jurisdiction did not extend to Prudential’s third-party claims.<sup>295</sup> Ancillary jurisdiction exists when a district court exercises jurisdiction over a state law claim.<sup>296</sup> This jurisdiction disappears as soon as the original case is removed or finished.<sup>297</sup> The bankruptcy court can only exercise ancillary jurisdiction over a supplemental claim if the case was filed when the original lawsuit commenced.<sup>298</sup> Because Prudential’s claim was filed subsequent

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<sup>291</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 397; *see In re South Bay Medical Associates*, 184 Bankr. 963 (Bankr. C.D. Cal. 1995); *In re W.J. Services, Inc.*, 139 Bankr. 824 (Bankr. S.D. Tex. 1992); *In re Eads*, 135 Bankr. 387 (Bankr. E.D. Cal. 1991); *see also In re Feifer Industries*, 141 Bankr. 450 (Bankr. N.D. Ga. 1991) (declines to exercise supplementary jurisdiction).

<sup>292</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 397 (“Other [grants of jurisdiction] include diversity jurisdiction, 28 U.S.C. § 1332, admiralty jurisdiction, 28 U.S.C. § 1333, patent jurisdiction, 28 U.S.C. § 1338, postal matter jurisdiction, 28 U.S.C. § 1339, and, of course, bankruptcy jurisdiction, 28 U.S.C. § 1334.”).

<sup>293</sup> *Id.* at 398 (discussing the limits imposed on bankruptcy courts by 28 U.S.C. § 157(a)).

<sup>294</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 398

<sup>295</sup> *See id.*

<sup>296</sup> *Id.*

<sup>297</sup> *Id.* at 399. *See generally* Peacock v. Thomas, 516 U.S. 349, 354 (1996) (noting that “a federal court may exercise ancillary jurisdiction ‘(1) to permit disposition by a single court of claims that are, in varying respects and degrees, factually interdependent; and (2) to enable a court to function successfully, that is, to manage its proceedings, vindicate its authority, and effectuate its decrees.’” (quoting *Kokkonen v. Guardian Life Ins. Co.*, 511 U.S. 375, 379-380, (1994))).

<sup>298</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 399. *See generally, e.g.*, *Felice v. Sever*, 985 F.2d 1221, 1225 (3d Cir.), *cert. denied*, 509 U.S. 923 (1993); *Rheuport v. Ferguson*, 819 F.2d 1459, 1467 n.13 (8th Cir. 1987).

to New Era's original petition, no ancillary or supplemental jurisdiction existed over Prudential's claim.<sup>299</sup>

#### 4. Summary

Because the third-party claims were not filed at the commencement of the suit, the parties' identity would not affect the administration of the estate, and were not related to the New Era's original bankruptcy filing, Judge Fox ruled that the bankruptcy court did not have jurisdiction over Prudential's third-party claims against Bennett, New Era, and the thirty-nine entities.<sup>300</sup> As a result, subject matter jurisdiction did not exist in this case, the court did not need to discuss the merits of the trustee's motion to sever the claims, and the court dismissed Prudential's claim.<sup>301</sup>

#### c. *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1891 (Bankr. E.D. Pa. July 22, 1996).

After the court ruled against Prudential's initial objection to proposed settlement plans, the trustees pushed forward with settlement agreements with the involved entities.<sup>302</sup> In mid-July 1996, Trustee Adams sought approval of three settlement agreements in relation to New Era's bankruptcy proceedings.<sup>303</sup> Adams' proposed settlement agreement involved claims against Harvard University, Princeton University and the University of Pennsylvania.<sup>304</sup> Additionally, Adams sought approval of an agreement in relation to claims against New Era's estate by "Laurence S. Rockefeller, Frank E. Richardson, III, The Richardson Foundation, William Thatcher Longstreth, John H.T. Wilson, James J. O'Neill, Henry F. Harris, Vivian Piasecki, The Ross Family

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<sup>299</sup> *In re Foundation for New Era Philanthropy*, 201 B.R. at 399.

<sup>300</sup> *Id.*

<sup>301</sup> *Id.*

<sup>302</sup> *See generally* *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1891, \*1 (E.D. Pa. July 22, 1996) (discussing certain settlement agreements); *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 (Bankr. E.D. Pa. October 24, 1996) (same); *In re Foundation for New Era*, Nos. 95-13729 and 95-0237 (Bankr. Ct. E.D. Pa.) (containing the final settlement agreements).

<sup>303</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1891, at \*1.

<sup>304</sup> *Id.*

Fund, the Benfamil Charitable Trust, George Bennett, Frank Richardson and the Whitehead Foundation.”<sup>305</sup> Objectors to the proposed settlement agreements argued that they did not have enough information to determine whether the settlement agreements were fair to all parties involved.<sup>306</sup>

As previously mentioned, the trustee sought to recover monies paid out to “net positive” organizations in New Era’s pyramid scheme.<sup>307</sup> However, many of the organizations involved could not return a full 100% of the funds received. Accordingly, the trustee took an opportunity to settle with certain entities for less than a 100% return.<sup>308</sup> In the proposed settlement agreement, Harvard was to return \$502,500 to the estate, which would be a 93% return of its net positive obligation.<sup>309</sup> Princeton University was to pay \$2,106,972.95, which would equal a 91.3% return of its net positive obligation.<sup>310</sup> Similarly, the University of Pennsylvania was supposed to repay 92.4% of its net positive obligation, equaling between \$2,418,867.50 and \$2,618,867.50.<sup>311</sup> The settlement agreements with each of the Universities included a “most favored nation” type

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<sup>305</sup> *Id.* at \*1-2.

<sup>306</sup> *Id.* at \*2. The “objectors” included Rescue Mission Alliance of Syracuse, Wesley Skinner, and Sacred Works, Inc. *Id.* Although these objectors were represented by a law firm, John Carroll, former Trustee was admitted to represent these entities pro hac vice. *Id.*

<sup>307</sup> “[T]he concept of a ‘net positive obligation’ is defined in these circumstances as the amount paid to the universities less the amount donated to the debtor on their behalf less funds deposited by them and still held by the debtor. While the settlement implicitly permits these three universities to retain the amount paid to them to the extent of donations made on their behalf, the settlement also requires that those who made the donations withdraw their claims against the estate.” *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1891, at \*10.

<sup>308</sup> *Id.* at \*7 (“[I]f the trustee proposed to settle for less than 100% of the listed net positive obligation, he was still obligated to comply with the notice and hearing requirements of Fed. R. Bankr. P. 9019(a).”).

<sup>309</sup> *Id.* at \*8.

<sup>310</sup> *Id.*

<sup>311</sup> *Id.*

provision that enabled the Universities to reopen settlement negotiations if the trustee settled more favorably with similarly situated entities.<sup>312</sup>

The trustee stated four reasons for settling for less than a 100% return: (1) uncertainty of the outcome if litigation ensued; (2) the costs of litigation might be greater than the costs forgone by the settlement agreement; (3) settlement reaps immediate payment; and (4) the settlement agreements could be a “springboard” to convince other entities to settle.<sup>313</sup> As such, Trustee Adams explained that these “discounts” would cause greater overall benefit for the estate.<sup>314</sup>

In his professional capacity, a trustee is “a fiduciary of the bankruptcy estate, *i.e.*, its creditors.”<sup>315</sup> “When a bankruptcy trustee seeks to compromise a dispute, he must seek court approval on notice and hearing.”<sup>316</sup> A bankruptcy court must review the trustee’s actions to ensure that the trustee acts in accordance with the fiduciary duties owed to the creditors.<sup>317</sup> Although trustees may act within the ordinary course of their duties without much oversight from the court, when a trustee begins to act “outside the ordinary course, the usual articulated standard for review is the business judgment standard.”<sup>318</sup> Bankruptcy courts have interpreted the business judgment

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<sup>312</sup> *Id.* at \*8-9 (“Those similarly situated parties – of which there are eleven – include the Dartmouth College Alumni Fund, Cornell University, and the University of Virginia. The trustee explained that all three of these universities insisted upon this provision so as not to be penalized for being among the first to reach an accord with the trustee.”).

<sup>313</sup> *Id.* at \*11-12.

<sup>314</sup> *Id.* at \*11-13 (noting that “the trustee testified that these three proposed agreements would enable him to reach similar accord with most if not all of the net positive obligors and thereby be in a position to distribute funds sooner to the creditors in this case, many of whom are charitable entities”).

<sup>315</sup> *Id.* at \*15.

<sup>316</sup> *Id.* at \*14; *see* Fed. R. Bankr. P. 9019(a) (“Compromise. On motion by the trustee and after a hearing on notice to creditors, the United States trustee, the debtor and indenture trustees as provided in Rule 2002 and to such other entities as the court may designate, the court may approve a compromise or settlement.”).

<sup>317</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1891, at \*15-16 (citing *In re Riverside-Linden Inv. Co.*, 925 F.2d 320 (9th Cir. 1991)).

<sup>318</sup> *Id.* at \*16 (citing *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U.S. 523 (1943); *In re Titusville Country Club*, 128 B.R. 396 (Bankr. W.D. Pa. 1991)).



rule to mean that the trustee must obtain “reasonable terms” in a settlement agreement, and the trustee must be given a certain degree of discretion.<sup>319</sup>

In addition to the court’s approval of the trustee’s actions, some of the creditors must also approve the settlement agreements.<sup>320</sup> Although support of settlement agreements need not be unanimous by all creditors, a certain contingency must be “on board.”<sup>321</sup> In this situation, the court noted that Trustee Adams was acting with a contingency support when he sought approval of the settlement agreements.<sup>322</sup> This is an important aspect in enforcing “approved” settlement agreements.

Similarly to valuing the assets of an estate, when a trustee seeks approval of a settlement agreement, the trustee must seek a fair and reasonable value for compromising litigation.<sup>323</sup> The value of litigation has three “components” that must be taken into consideration: (1) “the amount likely to be awarded by final judgment;” (2) “the cost of obtaining that award;” and (3) “the portion of the award that may be collected on the execution.”<sup>324</sup> “The actual recovery, less costs, is the value of the litigation.”<sup>325</sup> Litigation, unlike cash, is a very difficult asset for a court to value.<sup>326</sup> As such, the most common method of valuation is for the trustee to offer a range of likely recovery coupled with the likely costs of litigation in comparison with the proposed settlement.<sup>327</sup>

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<sup>319</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1891 at \*16, \*20.

<sup>320</sup> *Id.* at \*21.

<sup>321</sup> *Id.*

<sup>322</sup> *Id.*

<sup>323</sup> *Id.* at \*22; *see also* *In re Abbotts Dairies of Pennsylvania, Inc.*, 788 F.2d 143, 147 (3d Cir. 1986).

<sup>324</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1891 at \*22-23.

<sup>325</sup> *Id.* at \*23.

<sup>326</sup> *Id.* at \*24 (“Of all types of assets, litigation is among the most difficult for a bankruptcy court to value.”). *Id.* at \*23 n. 14 (“In considering the appropriateness of a trustee sale of an asset, the Third Circuit has noted: ‘Traditionally, courts have held that “fair and valuable consideration is given in a bankruptcy sale when the purchaser pays 75% of the appraised value of the assets.”’” *In re Abbotts Dairies of Pennsylvania, Inc.*, 788 F.2d at 143 (quoting *In re Rock Indus. Mach. Corp.*, 572 F.2d 1195, 1197 n.1 (7th Cir. 1978))).

<sup>327</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1891 at \*24-25.

In regards to the proposed settlement agreements, the objectors raised three main concerns; they argued that: (1) the trustee failed to demonstrate that the estate was not entitled to a 100% return; (2) the trustee was entitled to a greater than 100% recovery in litigation; and (3) the “most favored nation” provision would force the trustee to “rebate” portions of the settlement at a later time.<sup>328</sup> Despite the objectors’ concerns, Judge Fox found their objections unpersuasive for three main reasons, which are discussed below.<sup>329</sup>

First, Judge Fox noted that the objectors’ reliance on the “law of the case” was ill-placed.<sup>330</sup> The objectors explained that the order should be vacated because they received insufficient information to determine whether the trustee’s valuation was “fair.”<sup>331</sup> The objectors sought relief from an order under the provisions of the bankruptcy code.<sup>332</sup> However, the Mar. 26, 1996 order had already been entered and the appeals period had passed.<sup>333</sup> Further, because the trustee did not settle for amounts outside of the scheduled amount, the judge determined that the proposed settlement agreements were fair and the objectors’ concerns were misplaced.<sup>334</sup>

Secondly, the objectors’ asserted that Trustee Adams fell short of his business judgment rule duty.<sup>335</sup> “The objectors posit that the trustee’s claims are virtually assured, the universities are financially able to pay any judgment and the costs of litigation far less than the trustee’s estimate of 10% of the claim.”<sup>336</sup> However, the objectors fail to take into account the costs of litigation.<sup>337</sup>

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<sup>328</sup> *Id.* at \*25-26.

<sup>329</sup> *Id.* (“I find all three objections unpersuasive”).

<sup>330</sup> *Id.*

<sup>331</sup> *Id.* at \*29.

<sup>332</sup> *Id.*

<sup>333</sup> *Id.* at \*28.

<sup>334</sup> *Id.*

<sup>335</sup> *Id.* at \*34.

<sup>336</sup> *Id.*

<sup>337</sup> *Id.*

The costs of litigation can be extensive, and by settling, the parties could avoid paying attorneys fees and avoid the chance of losing any claim to the money. As such, the trustee reasoned, and the judge agreed, that settling rather than litigating could save the estate significant amounts of money.<sup>338</sup>

Finally, in response to the objectors' most favored nation provision concerns, Judge Fox explained that the provisions applied only to settlement agreements worked out by the trustee rather than any litigation that might ensue.<sup>339</sup> As such, the entities agreeing to settle as the initial parties approving settlement simply did not want to be penalized by agreeing to settle earlier than other similarly situated entities.<sup>340</sup> The objectors argued that because litigation might result in a lower than 100% or 92% return of net proceeds from the "winners," the size of the estate may later be adversely be affected by defenses that other universities or donors may have.<sup>341</sup> "[S]o long as the trustee does not consent to more favorable terms [in other settlement agreements], the outcome of litigation will not require the trustee to rebate any settlement funds to these three universities."<sup>342</sup> Thus, the most favored nation provision would only extend to those situations in which the trustee sought settlement from similarly situated parties.

In sum, Judge Fox concluded that "the inclusion of a conditional rebate provision in these settlement agreements does not yield the result that the trustee is settling for a sum less than is reasonable under these circumstances. The condition which would trigger such a rebate seems to be very unlikely to arise, as it would require the trustee's acquiescence, something his counsel has

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<sup>338</sup> *Id.*

<sup>339</sup> *Id.* at \*43.

<sup>340</sup> *Id.*

<sup>341</sup> *Id.*

<sup>342</sup> *Id.* at \*44.

promised would not occur.”<sup>343</sup> Ultimately, Judge Fox approved the proposed settlement agreements citing two main reasons: (1) the settlement agreements quickly resolved some debtors’ claims, and (2) approving settlement agreements at an early stage may encourage other parties to follow suit.<sup>344</sup>

**d. *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 (Bankr. E.D. Pa. October 24, 1996).**

Perhaps “encouraged” by the previously approved settlement agreements, shortly after Judge Fox approved the Universities’ agreements, Trustee Adams sought approval of two new settlement agreements with the Nature Conservancy and One to One Partnership, Inc..<sup>345</sup> Similarly to the previous hearing before the bankruptcy court, Prudential objected to the proposed settlements.<sup>346</sup>

Based on the complexity of the New Era estate and the sheer number of contingent claims, Judge Fox began his opinion with an introductory lesson of the terms used to define creditors and debtors in New Era’s bankruptcy proceeding.<sup>347</sup> Although three groups existed – depositors, beneficiaries, and grantees – these groups were divided into two subgroups – the “positives” who

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<sup>343</sup> *Id.*

<sup>344</sup> *Id.* at \*46.

<sup>345</sup> See generally *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 (Bankr. E.D. Pa. October 24, 1996).

<sup>346</sup> *Id.*

<sup>347</sup> *Id.* at \*4-5. Some of these definitions included the following:

A "beneficiary" is an entity which was "a designee of a donor;" a "donor" is an entity "that sent money to the Debtor with the expectation that the donated money would be matched by the Debtor" and the donation and matched sums would be paid to a beneficiary. "Matching funds" refer to the amount the debtor promised to pay to a beneficiary or a depositor in addition to the donation or deposit, and which was generally equal to the amount received by the debtor from a donor or depositor. A "depositor" is an entity which invested funds with the debtor in the expectation of receiving back its deposit plus matching funds.

*Id.* These definitions are used throughout this Part.

had a repayment obligation and the “negatives” who had claims against the estate.<sup>348</sup> Many of the entities that had claims against the estate had not only “negative pecuniary claims” for the amount deposited and lost, but also “nonpecuniary claims” for the amount New Era promised to the debtor but failed to pay.<sup>349</sup>

**a. The Nature Conservancy’s Proposed Settlement Agreement**

As a “positive” in the Ponzi, the Nature Conservancy netted \$568,000.00 from New Era.<sup>350</sup> \$284,000.00 represented the “return of principle,” whereas \$284,000.00 represented the “matched funds.”<sup>351</sup> Subsequent to receiving the matched funds, the Nature Conservancy deposited an additional \$2,000,000.00 in New Era.<sup>352</sup> This amount was neither doubled nor repaid.<sup>353</sup> The Nature Conservancy’s funds were placed into numerous New Era related accounts, and at least one account holding \$1,025,458.66 was not commingled with other depositors’ money, but was segregated in its own account.<sup>354</sup>

The Nature Conservancy and Trustee Adams disagreed regarding the amount the donor was entitled to recover.<sup>355</sup> The Nature Conservancy argued that it was entitled to receive \$2,000,000.00 as a pecuniary claim, and could reserve the nonpecuniary claim of \$2,000,000.00 for New Era’s failure to pay the promised funds, whereas Trustee Adams asserted that the Nature Conservancy was entitled to a pecuniary claim of \$1,716,000.00 which represented the

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<sup>348</sup> *Id.* at \*5-6.

<sup>349</sup> *Id.* at \*6-7.

<sup>350</sup> *Id.* at \*7.

<sup>351</sup> *Id.*

<sup>352</sup> *Id.*

<sup>353</sup> *Id.*

<sup>354</sup> *Id.*

<sup>355</sup> *Id.* at \*8.

\$2,000,000.00 deposit less the original repayment of \$284,000.00.<sup>356</sup> The Nature Conservancy further argued that Trustee Adams wrongfully took control of the Nature Conservancy’s segregated account as part of the bankruptcy estate because the account should be “subject to an ‘express, resulting and/or constructive trust.’”<sup>357</sup>

Despite the disagreements, Trustee Adams proposed a settlement agreement by which “[t]he trustee will receive 25% of the funds in the segregated accounts (approximately \$276,400.00) while the Nature Conservancy will receive the remaining 75% (roughly \$830,000).”<sup>358</sup> The proposed agreement also provided that the Nature Conservancy would hold a right to a general unsecured claim against the estate for \$977,500.00, as well as an identical subordinated claim.<sup>359</sup>

#### **b. One to One Partnerships, Inc.’s Proposed Settlement Agreement**

Similarly to the Nature Conservancy, One to One also received matched funds from the early days of New Era’s scam.<sup>360</sup> One to One received a total of \$5,970,494.25 from New Era, \$3412,994.25 of which were matched funds and \$2,557,500.00 from principal payments.<sup>361</sup> After its initial receipt of matched funds, One to One invested an additional \$4,490,000.00 that was

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<sup>356</sup> *Id.*

<sup>357</sup> *Id.* An “express trust,” as defined by Black’s Law Dictionary is “the right, enforceable solely in equity, to the beneficial enjoyment of property to which another person holds the legal title; a property interest held by one person (the *trustee*) at the request of another (*the settlor*) for the benefit of a third-party (the *beneficiary*). For a trust to be valid, it must involve specific property, reflect the settlor’s intent, and be created for a lawful purpose.” BLACK’S LAW DICTIONARY 723 (2d Pocket ed. 2001). An “express trust” is “a trust created with the settlor’s express intent, usu. declared in writing; an ordinary trust as opposed to a resulting trust or a constructive trust.” *Id.* at 724. A “resulting trust” is “[a] trust imposed by law when property is transferred under circumstances suggesting that the transferor did not intend for the transferee to have the beneficial interest in the property.” *Id.* at 725. A “constructive trust,” on the other hand, is “[a] trust imposed by a court on equitable grounds against one who has obtained property by wrongdoing, thereby preventing the wrongful holder from being unjustly enriched. Such a trust creates no fiduciary duty.” *Id.* at 723-24.

<sup>358</sup> *Id.* at \*9.

<sup>359</sup> *Id.*

<sup>360</sup> *Id.* at \*10.

<sup>361</sup> *Id.*

unpaid as of New Era’s bankruptcy petition.<sup>362</sup> Also like the Nature Conservancy, some of One to One’s funds were deposited in a segregated account.<sup>363</sup> One to One asserted that it held a \$9,081,242.00 claim against the estate, whereas the trustee asserted that One to One held a pecuniary claim worth \$1,077,066.00.<sup>364</sup>

Much like the agreement proposed with the Nature Conservancy, the trustee proposed that One to One should receive a portion of the segregated funds in the amount of \$1,600,000.00 and hold a subordinated claim for \$400,000.00 against the estate.<sup>365</sup> The One to One proposed settlement agreement (as well as the one for the Nature Conservancy) also included a release provision for future claims (but not present and future players) who may have aided or participated in the scheme.<sup>366</sup> Hoping to place One to One in the group settlement category rather than litigating the issue of the rights of the segregated funds, the trustee decided to “conced[e] the funds in the segregated accounts to One to One, in return for [One to One’s] participation in the group settlement as a positive who is agreeing to repay its 85% of its net positive obligation.”<sup>367</sup>

Although many similarities existed between the Nature Conservancy settlement agreement and One to One’s settlement agreement, significant differences remained. One to One’s situation differed from the Nature Conservancy’s because One to One sought to exchange its potential of prevailing on its segregated funds claim (which would render One to One a net positive) in exchange for remaining outside of the group settlement and keeping a subordinated claim for

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<sup>362</sup> *Id.*

<sup>363</sup> *Id.*

<sup>364</sup> *Id.*

<sup>365</sup> *Id.* at \*11.

<sup>366</sup> *Id.*

<sup>367</sup> *Id.* at \*13-14.

\$400,000.00.<sup>368</sup> This is different from the Nature Conservancy because the trustee does not consider the Nature Conservancy to be a net positive in any calculable situation.<sup>369</sup>

### c. Reasonableness of Both Agreements

The trustee defended the reasonableness of the proposed settlement agreements on two grounds: (1) the potential costs of litigation could be extraordinary and (2) the estate could potentially lose the rights to the segregated accounts.<sup>370</sup> In addition to avoiding the costs of litigation, the trustee argued that approving this settlement agreement would likely encourage others to follow suit to attempt settlement agreements with the estate.<sup>371</sup>

“By virtue of 11 U.S.C. § 704, the trustee has the duty to liquidate estate assets as quickly ‘as is compatible with the best interests of parties in interest’ and to examine, and, if appropriate, object to claims raised against the estate.”<sup>372</sup> The motions for approving the two proposed settlement agreements involved Fed. R. Bank. P. 9019(a), which required the trustee to seek court approval.<sup>373</sup> This rule provides that a bankruptcy court has the “sound discretion” of approving a proposed settlement agreement and should do so if the agreement is in the “best interest of the estate.”<sup>374</sup> Although the bankruptcy court must approve or deny the proposed settlement agreements, the trustee has the duty of proving that the agreement is fair.<sup>375</sup> In an analysis of “fairness”, the bankruptcy court must not only acknowledge that compromise and expedience is

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<sup>368</sup> *Id.* at \*14.

<sup>369</sup> *Id.*

<sup>370</sup> *Id.* at \*16.

<sup>371</sup> *Id.* at \*17-18

<sup>372</sup> *Id.* at \*18 (quoting *In re Martin*, 91 F.3d 389 (3d Cir. 1996)).

<sup>373</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 at \*19.

<sup>374</sup> *Id.* at \*21 (discussing Fed. R. Bank. P. 9019(a)) (citing *In re Neshaminy Office Bldg. Associates*, 62 B.R. 798, 803 (E.D. Pa. 1986)).

<sup>375</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 at \*22; *see Matter of AWECO, Inc.*, 725 F.2d 293 (5th Cir.), *cert. denied*, 469 U.S. 880 (1984).



avored because it reduces administrative costs of the case,<sup>376</sup> but also evaluate the “amount of creditor support.”<sup>377</sup>

Unlike the settlement agreements previously approved,<sup>378</sup> the two proposed agreements involved segregated accounts.<sup>379</sup> Typically, it is nearly impossible for those who deposited money in a scheme to trace their own funds when the funds are pooled into a commingled account.<sup>380</sup> However, because New Era placed some of the Nature Conservancy and One to One’s deposited funds into segregated accounts, these two creditors could trace their funds and likely prevail on a claim that their funds were held in a constructive trust.<sup>381</sup> “[G]enerally, the recipient of property obtained by fraud does not obtain absolute title to it; instead, it may be subject to a constructive trust for the defrauded party’s benefit.”<sup>382</sup> Pennsylvania law provides that constructive trusts are equitable remedies.<sup>383</sup> “[I]t is well settled that where a constructive trust exists under state law, so that the debtor holds only bare legal title to the property subject to a duty to reconvey it to the

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<sup>376</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 at \*23 (citing *In re Martin*, 91 F.3d at 393; *In re Lakeland Development Corp.*, 48 B.R. 85, 90 (Bankr. D. Minn.) (and cases cited), *aff’d without op.*, 782 F.2d 1084 (8th Cir. 1985), *cert. denied sub nom.* *Anderson v. Spring Lake Park Partnership*, 476 U.S. 1130 (1986)).

<sup>377</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 \*23 (Bankr. E.D. Pa. October 24, 1996) (citing *In re American Reserve Corp.*, 841 F.2d 161-62 (7th Cir. 1987); *cf.* *In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768, 812 (3d Cir.), *cert. denied sub nom.* *General Motors Corp. v. French*, 516 U.S. 824 (1995)).

<sup>378</sup> *See generally In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1891 (E.D. Pa. July 22, 1996).

<sup>379</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 at \*24.

<sup>380</sup> *Id.* at \*25 (discussing *Cunningham v. Brown*, 265 U.S. 1 (1924)).

<sup>381</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 at \*26-27.

<sup>382</sup> *Id.* at \*26 (quoting *In re M&L Business Machine Co., Inc.*, 164 B.R. 148, 150 (D. Colo. 1994), *aff’d* 59 F.3d 1078 (10th Cir. 1995)).

<sup>383</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 at \*27 (citing *Partrick & Williams Co. v. Reliance Ins. Co.*, 456 A.2d 1348 (Pa. 1983); *Buchanan v. Brentwood Federal Sav. & Loan Assoc.*, 320 A.2d 117 (Pa. 1974); *In re Gebco Invest. Corp.*, 641 F.2d 143, 148-49 (3d Cir. 1981) (in appropriate circumstances a constructive trust may be imposed to prevent unjust enrichment); *Stauffer v. Stauffer*, 351 A.2d 236 (Pa. 1976) (same); *Gee v. Eberle*, 420 A.2d 1050 (Pa. Super. Ct. 1980) (same); *In re Cubbler*, 17 B.R. 674, 677 (Bankr. E.D. Pa. 1982) (“a constructive trust is not determined by reference to the intent of the parties but rather, is imposed despite the parties’ intent. Generally, a constructive trust arises whenever the courts find it necessary to meet the demands of justice, morality, conscience and fair dealing”)(footnotes omitted)).

rightful owner, the estate will hold the property subject to the same restrictions.”<sup>384</sup> “Accordingly, when the defrauded investor in a pyramid scheme is unable to prove that its deposit has been retained by the debtor, as opposed to being commingled and possibly used to repay one or more earlier investors, attempts at imposing a constructive trust have been rejected.”<sup>385</sup> However, if a creditor can trace the deposited funds, then the creditor may establish equitable ownership, *i.e.*, the existence of a constructive trust.<sup>386</sup>

In this situation, most of the funds deposited with New Era were commingled into one account held by Prudential.<sup>387</sup> As such, creditors’ whose money was placed into the “grab bag” account would be unlikely to identify or trace their own funds.<sup>388</sup> However, because the Nature Conservancy and One to One had segregated accounts, they could likely trace their own funds and establish a constructive trust.<sup>389</sup> Because of this likelihood, the trustee took into account the risks of litigation.<sup>390</sup> Because the risks included a high potential of loss, this aspect weighed heavily in favor of settlement.

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<sup>384</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893, at \*28 (citing *In re N.S. Garrott & Sons*, 772 F.2d 462 (8th Cir. 1985); *In re California Trade Technical Schools, Inc.*, 923 F.2d 641 (9th Cir. 1991) (property debtor held in trust at time of bankruptcy petition is excluded from bankruptcy estate); *In re Howard's Appliance Corp.*, 874 F.2d 88 (2d Cir. 1989) (property held in trust by debtor belongs to beneficiary of trust); *Matter of Yakel*, 97 B.R. 580 (D. Ariz. 1989) (debtor's attorney holds portion of tort settlement payment in constructive trust for state agency as reimbursement for agency's payment of debtor's medical expenses); *In re Dobbs*, 115 B.R. 258, 269 (Bankr. D. Idaho 1990); *In re Vichele Tops, Inc.*, 62 B.R. 788, 790 (Bankr. E.D.N.Y. 1986); *Goldberg v. New Jersey Lawyers' Fund*, 932 F.2d 273 (3d Cir. 1991) (to establish rights in bankruptcy as a trust recipient, claimant must demonstrate that trust relationship and its legal source exists)).

<sup>385</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 at \*30-31 (citing *In re Johnson*, 960 F.2d 396 (4th Cir. 1992); *First Federal of Michigan v. Barrow*, 878 F.2d 912 (6th Cir. 1989)).

<sup>386</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 at \*30-31 (citing *In re D.H. Overmyer Telecasting Co., Inc.*, 53 B.R. 963, 984 (N.D. Ohio 1984), *aff'd without op.*, 787 F.2d 589 (6th Cir. 1986); *In re Mark Benskin & Co., Inc.*, 135 B.R. 825 (Bankr. W.D. Tenn. 1991); *In re Gherman*, 103 B.R. 326, 332 (Bankr. S.D. Fla. 1989) (“Imposition of a constructive trust is justified to prevent unjust enrichment where misappropriated funds have been traced to specific assets owned or held by a third-party, who is not a bona fide purchaser for value.”)).

<sup>387</sup> *In re Foundation for New Era Philanthropy*, 1996 B.R. LEXIS 1893 at \*32.

<sup>388</sup> *Id.*

<sup>389</sup> *Id.*

<sup>390</sup> *Id.* at \*33-34 (“There is considerable risk that the trustee would not prevail concerning his right to receive the funds in the segregated accounts; while there would be no collection difficulties if the trustee did prevail, there would be

Based on the likelihood of adverse litigation, the cost of litigation, and the “follow the leader” effect of approving settlements, Judge Fox deemed the proposed agreements reasonable in light of the circumstances.<sup>391</sup> Accordingly, the bankruptcy court approved the compromised settlement agreements.<sup>392</sup>

### e. Final Settlement

A little more than one year after New Era filed for bankruptcy, the trustee presented Judge Fox with a comprehensive agreement to settle with the majority of “victims.”<sup>393</sup> “U.S. Bankruptcy Judge Bruce I. Fox approved a \$39 million settlement August 22[, 1996,] that . . . allowed agencies that lost money through New Era to receive as much as 65 cents on every dollar invested – much of that money coming from organizations that profited from New Era’s dealings.”<sup>394</sup> Considered a creative, ingenious document, the settlement agreement reduced the amount lost in New Era’s estate from \$500 million to \$135 million, thereby minimizing the costs of the Ponzi.

## 2. U.S. v. Bennett

In addition to the bankruptcy proceedings, the New Era debacle brought about numerous criminal proceedings. By mid-May 1995, the Pennsylvania Attorney General brought an 82-count indictment against Bennett.<sup>395</sup> The indictment alleged as follows:

1. Count One-Bank fraud, 18 U.S.C. § 1344.
2. Counts Two-Third-five-Mail and wire fraud, 18 U.S.C. §§ 1341 & 1343.

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some costs and delays involved in the litigation; and no creditor other than PSI - which holds a contingent claim - opposes these settlement terms. Indeed, general creditor interests are enhanced for reasons detailed in my approval of the group settlement proposal.”).

<sup>391</sup> *Id.*

<sup>392</sup> *Id.* at \*38.

<sup>393</sup> Settlement Agreement, In re Foundation for New Era, Nos. 95-13729 and 95-0237 (Bankr. Ct. E.D. Pa. July 21, 1997).

<sup>394</sup> *Settlement Reached in New Era Case, supra* note 221.

<sup>395</sup> Berger, *supra* note 75 (noting that by mid-May, the Pennsylvania Attorney General indicted Bennett for fraud). *See generally* PACER Criminal Docket for Case #2:96-cr-00503-EL-1 (USA v. Bennett).

3. Count Thirty-Six-False statement to the government, 18 U.S.C. § 1001.
4. Counts Thirty-seven-Thirty-nine-False tax returns, 26 U.S.C. § 7206.
5. Count Forty-Impending the Internal Revenue Service, 26 U.S.C. § 7212.
6. Counts Forty-one-Five-five-Money laundering, 18 U.S.C. § 1957.
7. Counts Fifty-six-Eighty-two-Money laundering to promote scheme, 18 U.S.C. § 1956(a)(1)(A)(1).<sup>396</sup>

Given the list of charges, Bennett originally faced up to 907 years in prison as well as a \$28 million fine.<sup>397</sup> Judge Edmund Ludwig set Bennett's bail at \$100,000, which Bennett promptly made.<sup>398</sup>

The United States' case against Bennett lasted until October 1, 1999, when the United States Supreme Court denied certiorari.<sup>399</sup> Although no full criminal trials ensued, numerous evidentiary and sentencing issues arose during the four-year course of the trial.<sup>400</sup>

Perhaps overcome by his circumstances, Bennett initially entered a plea of not guilty by reason of insanity on October 1, 1996.<sup>401</sup> His "religious fervor" defense was largely based on

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<sup>396</sup> *United States v. Bennett*, 29 F. Supp. 2d 236, 236-37 (E.D. Pa. 1997) ("Several of the money laundering charges are based on [defendant's] expenditures to promote New Era. Other[s] result from [his] purchases . . . of homes for himself and his children, luxury cars, and first-class world-wide travel.").

<sup>397</sup> *Settlement Reached in New Era Case*, *supra* note 221; *Man Accused in Charity Scheme Faces 82 Charges*, *supra* note 33.

<sup>398</sup> PACER Criminal Docket for Case #2:96-cr-00503-EL-1 (USA v. Bennett) ("Order dated 1/3/96 setting conditions of release as to John G. Bennett, Jr., bail set at \$100,000.00 secured by property known as 313 Norris Hall Lane, Norristown, PA with agreement of forfeiture; deft to remain at this residence by curfew between the hours of 8:00 P.M. to 8:00 A.M. 7 days a week and subject to electronic monitoring, travel restricted to EDPA. With permission to visit friends in JN, permitted once a month to Harvard for medical appointments as to medical psychiatric treatments, etc.").

The case was originally assigned to Judge Marjorie O. Rendell; however, on October 1, 1996, the case was reassigned to Judge Edmund V. Ludwig. PACER Criminal Docket for Case #2:96-cr-00503-EL-1 (USA v. Bennett). Judge Ludwig presided throughout the remainder of the USA v. Bennett while the case remained in the district court. *See* PACER Criminal Docket for Case #2:96-cr-00503-EL-1 (USA v. Bennett).

<sup>399</sup> *Bennett v. United States*, 528 U.S. 819 (1999).

<sup>400</sup> *See generally infra* Part III.b. (discussing the various cases of *United States v. Bennett*).

<sup>401</sup> PACER Criminal Docket for Case #2:96-cr-00503-EL-1 (USA v. Bennett); *see Settlement Reached in New Era Case*, *supra* note 221 (discussing Bennett's plea of not guilty).

Bennett's subjective belief that he was doing God's will.<sup>402</sup> Contrary to Bennett's defense, a court appointed forensic psychiatrist evaluated Bennett and found that he was competent to stand trial.<sup>403</sup> The judge expeditiously ruled that the insanity defense would not be allowed.<sup>404</sup> Shortly after the judge's ruling, Bennett changed his plea from not guilty to nolo contendere.<sup>405</sup> Bennett's attorney, Gregory P. Miller, opined that the judge's initial ruling against Bennett made it impossible for him to prevail on a not guilty plea.<sup>406</sup> Upon the changed plea, Judge Ludwig set Bennett's sentencing hearing for June 26, 1997, and requested that the government provide Guidelines based calculation recommendations.<sup>407</sup> Even though Judge Ludwig ruled against Bennett's attempted insanity defense, Bennett sought to introduce evidence regarding his lack of mental culpability to commit the fraud because of his delusions.<sup>408</sup>

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<sup>402</sup> *United States v. Bennett*, 29 F. Supp. 2d 236, 237 (E.D. Pa. 1997); see also Carnes, *New Era's Bennett to Prison*, *supra* note 9 ("Bennett's defense team says he was driven not by criminal intent but by unrestrained 'religious fervor,' a defense strategy the judge did not allow."). As previously mentioned, Bennett explained that "[a]s the years passed by, the desire became a dream, the dream became a need, the need became an obsession, the obsession became a fantasy, and the fantasy became a delusion." Carnes, *Bennett 'Dream' Became 'Delusion'*, *supra* note 9.

<sup>403</sup> *Bennett*, 29 F. Supp. 2d at 236 n.1 (citing 18 U.S.C. § 4241(a) & (b)). The court appointed Gary M. Glass, M.D. "to aid the court in sentencing." PACER Criminal Docket for Case #2:96-cr-00503-EL-1 (USA v. Bennett).

<sup>404</sup> Bennett changed his plea from not guilty to nolo contendere on March 27, 1997. PACER Criminal Docket for Case #2:96-cr-00503-EL-1 (USA v. Bennett). This change of pleading is made possible by F.R.Cr.P. 11(a)(2). *Id.*

<sup>405</sup> *Voices' defense denied in fund raising fraud case*, *supra* note 180; Tony Carnes, *New Era's Bennett Pleads 'No Contest' to Fraud*, CHRISTIANITY TODAY, 1997 ("Bennett's 'no contest' plea on 82 fraud charges followed a federal judge's rejection of his 'religious fervor' defense."). Bennett officially changed his plea on March 27, 1997. PACER Criminal Docket for Case #2:96-cr-00503-EL-1 (USA v. Bennett).

<sup>406</sup> Carnes, *New Era's Bennett Pleads 'No Contest' to Fraud*, *supra* note 405.

<sup>407</sup> *Id.* Enacted by Congress in 1987, the Sentencing Guidelines were a result of the Federal Sentencing Act of 1984. John D. Burrow & Barbara A. Koons-Witt, *Elderly Status, Extraordinary Physical Impairments, and Intercircuit Variation*, 11 ELDER L. J. 273 (2003). The Guidelines were proposed with the hopes of achieving three objectives: "(1) honesty in sentencing; (2) uniformity in sentencing; and (3) proportionality in sentencing." *Id.* at 279.

<sup>408</sup> See generally *Bennett*, 29 F. Supp. 2d at 236 (discussing the admissibility of medical evidence relating to Bennett's mental capability).

**a. Pretrial Evidentiary Hearing -- *United States v. Bennett*, 29 F. Supp. 2d 236, 240 (E.D. Pa. 1997).**

Even though Bennett changed his plea from defense by reason of insanity to nolo contendere, Bennett sought to present evidence regarding his mental culpability to actually commit the crimes.<sup>409</sup> As Judge Ludwig's opinion explains:

According to defendant's mental health experts . . . defendant, who is now age 59, is suffering from a severe personality disorder and also from brain dysfunction or cognitive damage –'slippage'-resulting from automobile accident head traumas a number of years ago. These conditions, [the expert's] maintain, were accompanied by his delusion, or fantasy, that there were anonymous donors whose contributions would make New Era economically feasible. [The experts] portray defendant as having a sincere and genuine belief that he was doing God's will and that New Era was a "Kingdom Focus" to end suffering and ameliorate the world for God's glory.<sup>410</sup>

The government's experts disagreed with the diagnoses by Bennett's experts and objected to the admissibility of such evidence based of Federal Rule of Evidence 704(b).<sup>411</sup> In *United States v.*

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<sup>409</sup> See generally *Bennett*, 29 F. Supp. 2d at 236 (noting that "[t]he issues relate solely to mens rea and not to the defense of insanity"); *Voices' defense denied in fund raising fraud case*, *supra* note 180.

<sup>410</sup> *Bennett*, 29 F. Supp. 2d at 238; see also Carnes, *New Era's Bennett Pleads 'No Contest' to Fraud*, *supra* note 405 ("In March, Bennett's attorneys told [Judge] Ludwig that Bennett suffered from an 'unchecked religious fervor' that caused him to believe that his promise to double investors' money with matching funds from nonexistent 'anonymous donors' was not fraud but his 'mission from God to change the world.' Defense witness Robert L. Sadoff, director of forensic psychiatry at the Hospital of the University of Pennsylvania, said Bennett, though sane, suffered from a 'kingdom focus' and believed that God talks to him 'telling him what he must do.'"). Gregory Miller, Bennett's attorney, explained, "the defendant knew the difference between right and wrong, but was so overtaken by voices claiming he was on a 'mission from God' that he believed he was above the law." *Bennett*, 29 F. Supp. 2d at 236 (discussing Bennett's motion for an insanity plea); see also *Voices' defense denied in fund raising fraud case*, *supra* note 180 ("Bennett had planned to argue a personality disorder and brain damage from two car accidents had turned him into a religious zealot who did not believe his actions were wrong.").

<sup>411</sup> *Bennett*, 29 F. Supp. 2d 236, 238 (E.D. Pa. 1997); see also Carnes, *New Era's Bennett Pleads 'No Contest' to Fraud*, *supra* note 405 ("[Dr.] Sadoff, a physician examining Bennett, testified that Bennett suffered from a mixed personality disorder that involved narcissism, obsessive compulsive behavior, and mood cycles aggravated by brain damage – which the defense said Bennett received from two auto wrecks. Martin Kelley, a prosecution psychiatrist from Harvard Medical School, replied that a barrage of tests over four months showed that Bennett faked his mental illness. The judge ruled against allowing the defense's line of reasoning because it amounted to trying to argue that Bennett was both sane and insane at the same time."). Judge Ludwig noted that these questions were governed by Federal Rule of Evidence 704(b), which states that the expert can testify to the mental health of the examinee, but may not testify as to whether the defendant actually had the required mental state at the time the crime was committed. *Bennett*, 29 F. Supp. 2d at 239; see also *United States v. Boyd*, 55 F.3d 667, 670-71 (D.C. Cir. 1995) (discussing the applicability of rule 704(b) to a police officer's testimony); *United States v. Thigpen*, 4 F.3d 1573, 1580 (11th Cir. 1993) (discussing the admissibility of a psychiatrist's testimony regarding defendant's schizophrenia).

*Bennett*, Judge Ludwig of the Eastern District of Pennsylvania held that experts could provide testimony in relation to Bennett’s mens rea, but could not provide opinions concerning whether Bennett actually had the requisite mens rea when committing the crime.<sup>412</sup>

Upon his ruling, Judge Ludwig explained the parameters of Rule 704’s evidentiary limitations.<sup>413</sup> Rule 704 governs the admissibility of expert testimony.<sup>414</sup> Although a defendant’s morality may be relevant to an insanity defense, Judge Ludwig noted that the defendant would be required to show *how* the morality affected the defendant’s state of mind.<sup>415</sup> In this case, Bennett dropped his insanity plea, and, as such, “defendant is presumed . . . to have acted knowingly and with awareness of the consequences of his actions.”<sup>416</sup> Admissible evidence must directly relate to one of the elements of the crime.<sup>417</sup> The court held:

The generalized conclusion, without more, that defendant believed he was doing God's work is not sufficient to negate the mens rea of statutory willfulness. What it tends to prove—the morality or goodness of defendant’s conduct—is not necessarily inconsistent with a guilty mens rea. It does not by itself tend to show that the alleged violation, here the filing of false tax returns, was not voluntary or intentional or was not a violation of a known legal duty.<sup>418</sup>

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<sup>412</sup> *Bennett*, 29 F. Supp. 2d at 240.

<sup>413</sup> *Id.*

<sup>414</sup> *See* Fed. R. Evid. 704. In its entirety, the Rule states:

(a) Except as provided in subdivision (b), testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact.

(b) No expert witness testifying with respect to the mental state or condition of a defendant in a criminal case may state an opinion or inference as to whether the defendant did or did not have the mental state or condition constituting an element of the crime charged or of a defense thereto. Such ultimate issues are matters for the trier of fact alone.

*Id.*

<sup>415</sup> *Bennett*, 29 F. Supp. 2d at 239-40 (“But, by itself, moral rectitude, regardless of the supremacy of the authority for such approbation, will not negate mens rea. Here, too, it is necessary for defendant to show how God’s influence or direction fits into a legally acceptable theory that he lacked the state of mind at issue.”).

<sup>416</sup> *Id.* at 240 (citing 18 U.S.C. § 17; *Leland v. Oregon*, 343 U.S. 790, 799 (1952)).

<sup>417</sup> *Bennett*, 29 F. Supp. 2d at 241.

<sup>418</sup> *Id.*

Thus, the defense could offer evidence related to Bennett’s mental state so long as the evidence was directly related to “the actual mens rea for the particular crime charged in the indictment.”<sup>419</sup>

## **b. Sentencing Hearing**

Based on the government’s recommendations, independent medical evaluations, and the Sentencing Guidelines, on September 22, 1997, Judge Ludwig sentenced Bennett to 144 months in prison followed by three years of supervised release.<sup>420</sup> Dissatisfied with his sentence, Bennett appealed to the District Court for the Eastern District of Pennsylvania.<sup>421</sup> Following Bennett’s notice of appeal, Judge Ludwig filed a memorandum opinion on May 27, 1998, discussing the enhancement factors and downward departures that played a role in assessing the 144-month sentence.<sup>422</sup>

### **a. *United States v. Bennett*, 9 F. Supp. 2d 513 (E.D. Pa. 1998).**

After noting that Bennett orchestrated the “largest charity fraud in history,” Judge Ludwig provided his reasons for Bennett’s sentence.<sup>423</sup> This opinion included a discussion of the enhancement factors and downward departures that affected Bennett’s sentence.

## **1. Enhancement Factors**

First, Judge Ludwig addressed the eighteen level enhancement based upon the sheer amount of loss.<sup>424</sup> Noting that the amount of fraud must be calculated at the time the fraud is realized, the

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<sup>419</sup> *Id.*

<sup>420</sup> PACER Criminal Docket for Case #2:96-cr-00503-EL-1 (USA v. Bennett).

<sup>421</sup> *Id.* Bennett filed his motion to vacate the sentence based on 28 U.S.C. § 2255. *Id.* During these proceedings the U.S. attorney originally prosecuting the case, Richard Goldberg, withdrew as counsel and Judy Smith took over the state’s case against Bennett. *Id.* In addition to being dissatisfied with his sentence, Bennett was also seemingly dissatisfied with his original attorney because he filed his notice of appeal pro se from prison on October 2, 1997. *Id.* By April 27, 2006, however, during the appeal process, the court appointed Gino I. Benediti to represent Bennett pursuant to the Criminal Justice Act. *Id.*

<sup>422</sup> See *Bennett*, 29 F. Supp. 2d at 241; *United States v. Bennett*, 9 F. Supp. 2d 513, 518 (E.D. Pa. 1998).

<sup>423</sup> *Bennett*, 9 F. Supp. 2d at 518.



court explained that the criminal’s intention is irrelevant, so the Sentencing Guidelines did not take into account whether Bennett thought he was doing God’s work.<sup>425</sup> “A wrongdoer should [not] completely escape a sentence enhancement if his scheme involve[d] a substantial risk of loss merely because, under his own rosy scenario, no loss was intended.”<sup>426</sup> Given the lack of collateral in the check-kite scheme, New Era’s program had a significant risk of loss.<sup>427</sup> When the scheme was discovered, experts estimated that the amount of loss exceeded \$100 million.<sup>428</sup> Because the total amount of loss at the time of discovery exceeded \$80 million, eighteen levels were added pursuant to the Guidelines upper limit.<sup>429</sup>

Secondly, Bennett’s sentence was enhanced because “more than minimal planning” was involved.<sup>430</sup> At least one court has noted:

“More than minimal planning” means more planning than is typical for commission of the offense in a simple form. . . . [It] also exists if significant affirmative steps were taken to conceal the offense . . .

“More than minimal planning” is deemed present in any case involving repeated acts over a period of time, unless it is clear that each instance was purely opportune. Consequently, this adjustment will apply especially frequently in property offenses.<sup>431</sup>

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<sup>424</sup> *Id.* (citing U.S.S.G. § 2F1.1(b)(1)(S)).

<sup>425</sup> *Bennett*, 9 F. Supp. 2d at 518; *see also United States v. Shaffer*, 35 F.3d 110, 111 (3d Cir. 1994).

<sup>426</sup> *Bennett*, 9 F. Supp. 2d at 519 (quoting *United States v. Monaco*, 23 F.3d 793, 799 n. 10 (3d Cir. 1994)).

<sup>427</sup> *Bennett*, 9 F. Supp. 2d at 519 (“A lack of collateral usually means a substantial risk of loss.”); *see also Shaffer*, 35 F.3d at 114 (noting that collateral does not exist in check-kite schemes).

<sup>428</sup> *Bennett*, 9 F. Supp. 2d at 519-20.

<sup>429</sup> *Id.* (citing U.S.S.C. § 2F1.1(b)(1)(S)).

<sup>430</sup> *Bennett*, 9 F. Supp. 2d at 520 (“The conduct at issue lasted over a period of six years and involved a complex and recurrent pattern of activity.”) (citing U.S.C.G. § 2F1.1(b)(2)(A)); *see United States v. Marcum*, 16 F.3d 599, 603 (4th Cir. 1994), *cert. denied*, 513 U.S. 845 (1994) (“The comments to the guidelines deem more than minimal planning’ to be present in any case involving repeated acts over a period of time, unless it is clear that each instance was purely opportune.”).

<sup>431</sup> *United States v. Bean*, 859 F. Supp. 330, 334 (D. Ind. 1994) (quoting U.S.S.G. 2F1.1(b)(2)(A) and U.S.S.G. § 1B1.1).

Because Bennett continued his scheme for nearly six years and involved numerous innocent individuals, the New Era Ponzi clearly involved “more than minimal planning.” This aspect of Bennett’s sentencing was not contested even though it added two levels to Bennett’s sentence.<sup>432</sup>

Thirdly, Bennett’s sentence was enhanced for “misrepresentation of [New Era] acting on behalf of a charity.”<sup>433</sup> Although this aspect only added two levels to Bennett’s sentence, Bennett hotly contested this enhancement.<sup>434</sup> Bennett argued that he never misrepresented that he worked for a charity.<sup>435</sup> Because Bennett micro-managed New Era and New Era failed to file proper statements regarding the organization’s operations, the court found that Bennett’s “claim that he was unaware of New Era’s financial operations [was] incomprehensible and not credible.”<sup>436</sup> Throughout its operation, Bennett lied to investors, staff, accountants, and his attorneys about the existence of a board of directors and the nature of the company.<sup>437</sup> These lies “facilitated the

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<sup>432</sup> *Bennett*, 9 F. Supp. 2d at 520.

<sup>433</sup> *Id.* (citing U.S.S.G. § 2F1.1(b)(3)(A)). The prosecution’s pre-sentence report explained:

The misrepresentation took place in three ways. First, the defendant was able to secure a favorable rating from the Internal Revenue Service for the Foundation for New Era Philanthropy as a charitable organization, by submitting fraudulent documentation to the IRS, and by failing to disclose information regarding the New Concepts program to the IRS. The defendant did this knowing that the New Concepts program was in fact, a fraudulent scheme. The second aspect of the misrepresentation was the New Concept program itself, wherein the defendant told the victims of non-existent anonymous donors, in an effort to solicit contributions from them. In addition, the defendant used the favorable rating that he fraudulently received from the IRS to solicit funds from the victims. The third aspect to the misrepresentation is that the defendant used the charitable image of New Era to divert several million dollars to his for profit companies, which ultimately benefitted the defendant personally. Pursuant to § 2F1.1(b)(3)(A), two levels are added.

*United States v. Bennett*, 161 F.3d 171, 176 (3d Cir. 1998).

<sup>434</sup> *Bennett*, 9 F. Supp. 2d at 520.

<sup>435</sup> *Id.* (“Defendant asserts that he never ‘misrepresented’ his authority on behalf of New Era and that New Era was a ‘bona fide organization ... which carried out its charitable grant-making function as represented.’”).

<sup>436</sup> *Id.* The court explained that his defense was incredible because Bennett “micro-managed” his companies. *Id.* “He was an active and forceful CEO who created and organized his companies in his own image. He put together the programs, laid out all policies and directed their implementations, and selected personnel. He retained and conferred with attorneys and accountants. He solicited and met with representatives of potential investors and made or approved all major corporate decisions.” *Id.* (internal citations omitted).

<sup>437</sup> *Id.* at 521.

success of [New Era’s] illegal operation.”<sup>438</sup> Because Bennett continually lied to maintain New Era’s façade as a charity, the court refused to lower its two level enhancement for misrepresenting New Era as a charitable organization.<sup>439</sup>

Fourth, Bennett contested the addition of four levels because “[t]he offense affected a financial institution and defendant derived more than \$1 million in Gross Receipts.”<sup>440</sup> As for the “financial institution” aspect of this enhancement factor, Bennett operated his scheme through various bank accounts, most notably, those accounts held by Prudential.<sup>441</sup> Prudential is a securities firm, thereby making it a “financial institution.”<sup>442</sup> During the five and a half year operation, Bennett clearly derived more than \$1 million.<sup>443</sup> New Era transferred more than \$4 million to either Bennett’s personal accounts or to Bennett’s other for-profit companies.<sup>444</sup> More than \$2 million directly paid for Bennett’s personal investments, car, travel expenses, and home.<sup>445</sup> “As computed by the government auditor, the total of salary paid defendant, together with payments to his family members, Mainline Travel Agency, Merrill Lynch Investments, a Lexus dealership, personal credit card accounts, and for baseball tickets came to \$2,449,960.”<sup>446</sup> Accordingly, Judge Ludwig assessed the four level enhancement suggested by the government.<sup>447</sup>

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<sup>438</sup> *Id.*

<sup>439</sup> *Id.*

<sup>440</sup> *Id.* (citing U.S.S.G. § 2F1.1(b)(6)(B)). These financial institutions included not only Prudential Securities, but also Founders’ Bank and the National Bank of the Main Line. *Id.*

<sup>441</sup> *Bennett*, 9 F. Supp. 2d at 521.

<sup>442</sup> *Id.*

<sup>443</sup> *Id.*

<sup>444</sup> *Id.* “In the words of a government auditor, \$4,208,637 was transferred from New Era to ‘entities in which 100 percent interest is to John G. Bennett, Jr.’” *Id.* (internal citations omitted); *see also* U.S.S.G. § 3.B1.1(b), 18 U.S.C.A..

<sup>445</sup> *Id.*

<sup>446</sup> *Id.*

<sup>447</sup> *Id.*

Bennett also contested a four level increase for being the “organizer . . . of a criminal activity that involved five or more participants or was otherwise extensive.”<sup>448</sup> This enhancement factor requires that the defendant acted as a “leader” of an organization or that the defendant supervised others.<sup>449</sup> Although there were numerous “participants” in one sense given the number of investors, the New Era scheme had only two “criminal participants”: Bennett and Andrew Cunningham.<sup>450</sup> As an independent accountant, Cunningham kept the books and prepared taxes for New Era.<sup>451</sup> Other members were indeed involved in the scam; however, the “ostensibly innocent individuals” who were crucial in New Era’s operation were unaware of the criminal nature of the scheme.<sup>452</sup>

As an illustration – defendant’s assistant, acting at his behest, did not give the monthly “payment schedules” to New Era’s lawyers and accountants who had asked for them. She also withheld the list of New Era’s board members. Defendant utilized the services of several respected outside attorneys and accountants. Their work products, which gave defendant's companies the imprimatur of legality and reliability, reflected the carefully delimited information supplied to them by defendant. Moreover, he specifically directed Prudential Securities employees who handled investor inquiries not to divulge the non-segregated nature of these so-called “escrow” accounts.<sup>453</sup>

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<sup>448</sup> *Id.*

<sup>449</sup> *Id.* (“This enhancement does not apply to a solitary offender. *See* United States v. Badaracco, 954 F.2d 928, 934 (3d Cir. 1992). Also, in order to be a “leader,” defendant must supervise others, not simply be on equal footing with them. *See* United States v. Katora, 981 F.2d 1398, 1405 (3d Cir. 1992) (application of enhancement requires both “multiple participants and some differentiation in their relative culpabilities”). “Otherwise extensive” criminal activity is “based primarily on the number of people involved, criminally and noncriminally, rather than on other possible indices of the extensiveness of the activity.” *See* U.S.S.G. § 3B1.1, Application Note 3: “In assessing whether an organization is otherwise extensive, all persons involved during the course of the entire offense are to be considered.” *See* also United States v. Carrozzella, 105 F.3d 796, 802 (2d Cir. 1997) (relying upon Application Note 3).”).

<sup>450</sup> *Bennett*, 9 F. Supp. 2d at 522. “‘Participant’ is specifically defined in the Commentary to the Guidelines as ‘a person who is criminally responsible for the commission of the offense, but need not have been convicted.’” *Badaracco*, 954 F.2d at 934 n. 4 (citing U.S.S.G. § 3B1.1).

<sup>451</sup> *Bennett*, 9 F. Supp. 2d at 522. Cunningham also kept the books and prepared taxes for BGI, another of Bennett’s companies. *Id.* at n.22.

<sup>452</sup> *Id.* Some of these “ostensibly innocent individuals” who were instrumental in the New Era operation include: Mary Sinclair, who served as the Vice President for Administration; Tracy Ryan, the Assistant to the President and Garnts Administration; Bill Bennington, the Executive Associate for U.S. Programs; Richard Ohman, the Executive Associate for International Programs; Mark Staples, the Program Officer; Kristin Bennett, the Program Officer; and Donna Ebert, the Program Manager and Institute Administrator. *Id.* (citing Tr. Sept. at 73-75).

<sup>453</sup> *Bennett*, 9 F. Supp. 2d at 522-23 (internal citations omitted).

Because Bennett used “13 innocent individuals to assist in the commission of the crimes for which he was indicted,” the court’s four-level enhancement stuck.<sup>454</sup> Thus, Judge Ludwig’s enhancement was not based on his use of “five or more criminal participants.”

Rather, Bennett’s enhanced sentence was for otherwise extensive criminal activity. “‘Otherwise extensive’ criminal activity is ‘based primarily on the number of people involved, criminally and noncriminally, rather than on other possible indices of the extensiveness of the activity.’”<sup>455</sup> “‘In assessing whether an organization is otherwise extensive,’ all persons involved during the course of the entire offense are to be considered.”<sup>456</sup> This means that even a small fraud that is orchestrated by two people may be otherwise extensive when it involves the services of others.<sup>457</sup> As such, Bennett’s enhancement was based on the fact that he was the “manager” or “supervisor” of otherwise extensive criminal activity.<sup>458</sup> Because Bennett clearly played a supervisory role in constructing and micro-managing the Ponzi scheme, Judge Ludwig held that his actions fell within the gambit of the enhancement.<sup>459</sup> Even though Bennett may have been

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<sup>454</sup> *Id.* at 523.

<sup>455</sup> *Id.* (citing U.S.S.G. § 3B1.1).

<sup>456</sup> *Id.* at 522 (citing *United States v. Carrozzella*, 105 F.3d 796, 802 (2d Cir. 1997)).

<sup>457</sup> *See generally* U.S.S.G. § 3B1.b cmt. 3; Brief of Petitioner-Appellant at 11-12, *Fullwood v. United States*, No. 3-746 (Nov. 6, 2003), *available at* 2003 WL 22867720 (“In the light of the use of these unknowing participants, the “otherwise extensive” application was not clearly erroneous. *United States v. Davis*, 226 F. 3d 346, 360 (5th Cir. 2000), *cert. denied*, 531 U.S. 1181 (2001), held that applying the § 3B1.1(a) enhancement was not clearly erroneous because of the involvement of unwitting accomplices where the defendant operated “an advance-fee scheme in which he would agree to obtain funding for clients, but would never do so”. *Id.* at 348-49. There, the scheme involved employees of a financial company, loan brokers, lawyers, and those providing “due diligence” reports. *Id.*; *see also* *United States v. Sidhu*, 130 F. 3d 644 (5th Cir 1997) (§ 3B1.1 applied to physician involved in health care fraud where patients and insurance company’s employees were unknowing participants); *United States v. Allibhai*, 939 F. 2d 244, 253 (5th Cir. 1991), *cert. denied*, 502 U.S. 1072 (1992) (§ 3B1.1 applied to scheme involving only four participants that used services of outsiders such as bank employees). The use of unsuspecting participants was similarly extensive here. Application of the enhancement on that basis was not clearly erroneous.”).

<sup>458</sup> *Bennett*, 9 F. Supp. 2d at 524

<sup>459</sup> *Id.* Although Bennett’s challenges did not make it to the Supreme Court, this “otherwise extensive criminal activity” approach has been adopted by at least one appellate court. *See generally* *United States v. Appt*, 354 F.3d 1269 (10th Cir. 2004). In *Appt*, the Tenth Circuit:

propelled to “save the world,” he did so using fraud, which triggered an enhancement for “otherwise extensive activity.”<sup>460</sup>

The court also increased Bennett’s base level by two for abusing a position of trust.<sup>461</sup> As the court noted, “this enhancement applies when a defendant occupies a position of trust and uses that position in a way that significantly facilitates the commission of the crime.”<sup>462</sup> Bennett was the founder and CEO of New Era.<sup>463</sup> As such, he occupied a “position of trust” in a fiduciary relationship with the investors.<sup>464</sup> In this position, Bennett continually lied and misrepresented the nature of the Foundation and the construction of the board.<sup>465</sup> He used his position, capitalized on the falsely obtained tax-exempt status and garnered new support for the Ponzi.<sup>466</sup> Because Bennett continually used lies to “develop and encourage trust” in the organization, Judge Ludwig reasoned that this enhancement factor applied.<sup>467</sup>

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held that a sentence enhancement based on the defendant's role as a manager or supervisor of a criminal activity including fraud and money laundering in connection with the operation of a Ponzi scheme was supported by evidence that the defendant was the principal architect of the scheme and by his role as a vice president of an investment business central to the scheme. The court found that the defendant's extensive involvement supported the inference that the defendant played a supervisory role with respect to the participants below him in the organization.

Eric C. Surette, Annotation, *Construction and Application of U.S.C.G. § 3B1.1(b), 18 U.S.C.A., Providing Sentencing Enhancement for Manager or Supervisor of Criminal Activity-Fraud Offenses*, 22 A.L.R. FED. 417 (2007).

Additionally, in *U.S. v. Murad*, 954 F. Supp. 722 (D. Vt. 1992), the court held that months of planning a bankruptcy fraud, evidenced by numerous falsified documents constituted “otherwise extensive” criminal activity within the meaning of U.S.S.G. § 3B1.1(b).

<sup>460</sup> *Bennett*, 9 F. Supp. 2d at 524. (“While defendant may have been impelled by his intense hopes to ‘Save the World,’ he not only was aware that monies were entrusted to New Era, but he also took fraudulent steps to develop and encourage that trust.”).

<sup>461</sup> *Id.* at 27.

<sup>462</sup> *Id.* at 27 (quoting *United States v. Craddock*, 933 F.2d 338, 340 (3d Cir. 1993)).

<sup>463</sup> *Bennett*, 9 F. Supp. 2d at 527.

<sup>464</sup> *Id.*

<sup>465</sup> *Id.*

<sup>466</sup> *Id.*

<sup>467</sup> *Id.*

Bennett tried to blame the naivety of others rather than taking full responsibility for his actions.<sup>468</sup> Although Bennett argued that the “investors were greedy and, therefore, took their chances,” “taking advantage of a victim’s self-interest does not mitigate the seriousness of fraudulent conduct.”<sup>469</sup> Additionally, Bennett tried to slough off blame onto Cunningham and Prudential.<sup>470</sup> However, the court was disinclined to hear this excuse and “flatly rejected” his defense—“[t]hat reputable professionals, at his request, assisted him in carrying out these offenses hardly diminishes his role in them. If anything, the more cogent conclusion is to the contrary.”<sup>471</sup>

While addressing adjustment factors for Bennett’s role in the Ponzi, Judge Ludwig followed the prosecution’s recommendation and denied the requested adjustment for acceptance of responsibility.<sup>472</sup> According to U.S.S.G. § 3E1.1, a sentence may be adjusted for a defendant’s

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<sup>468</sup> See generally *id.* at 528-29 (discussing the role of greedy investors and Cunningham).

<sup>469</sup> *Id.* at 529 (citing U.S.S.G. § 3B1.3 Commentary).

<sup>470</sup> *Id.*

<sup>471</sup> *Id.* In sum, the court noted, “As repletely shown by the evidence, defendant knowingly, purposefully, and repeatedly misrepresented the nature and characteristics of the matching program in order to market it and effectuate large scale participation.” *Id.*

<sup>472</sup> *Id.* at 532. The prosecution’s pre-sentence report stated:

The defendant has entered a plea of nolo contendere in this case. However, he continues to deny any factual guilt and criminal intent for his actions. In his press release dated March 26, 1997, announcing his plea of nolo contendere, the defendant stated that he does not admit or adopt as true, the government's version of the facts, insofar as those facts relate in any way to the issue of his intent to commit the crimes alleged in the Indictment. The defendant further stated in his press release that he believes that his choice to cooperate with the bankruptcy trustee by surrendering substantially all of his assets to the trustee, which he claims had no relation to New Era, and to cooperate with the Attorney General of the Commonwealth of Pennsylvania and the United States Securities and Exchange Commission regarding civil enforcement activities brought by those entities regarding the collapse of New Era, indicates that he has accepted responsibility. It appears that his choice to cooperate with the bankruptcy trustee and the other parties bringing civil action against him benefits him in the same way as his plea of nolo contendere in the criminal matter. In other words, the defendant arrives at an outcome which may have been inevitable anyway, but with much less negative publicity and stress to himself and his family. His cooperation is not an indication that he admits wrongdoing. In fact, he stated as much in his press release. Furthermore, the defendant's for profit companies received approximately \$7 million as a result of his fraudulent activities, which ultimately resulted in benefit to him.

*United States v. Bennett*, 161 F.3d 171 (3d Cir. 1998).

acceptance of responsibility for his actions.<sup>473</sup> To obtain a reduction, the defendant must “clearly demonstrate acceptance of responsibility for his offense.”<sup>474</sup> In this situation, Bennett pleaded nolo contendere.<sup>475</sup> Even though nolo is not a guilty plea, the court noted that such a plea “will not ‘categorically bar reduction for acceptance of responsibility.’”<sup>476</sup> More importantly to the court, Bennett continually denied criminal intent and responsibility for his actions.<sup>477</sup> As the court stated, “he demonstrated a non-recognition and non-acceptance of personal responsibility.”<sup>478</sup> Accordingly, the court refused to adjust Bennett’s sentence based on “acceptance of responsibility.”<sup>479</sup>

## 2. Downward Departures

In addition to the numerous enhancement factor requests, the *Bennett* Court ruled on numerous downward departure requests as well.<sup>480</sup> Bennett was not granted a downward departure based on his age,<sup>481</sup> nor was his request for a downward departure based on family and

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<sup>473</sup> *Bennett*, 9 F. Supp. 2d at 529.

<sup>474</sup> *Id.*

<sup>475</sup> *Id.*

<sup>476</sup> *Id.* (quoting *United States v. Fields*, 39 F.3d 439, 446 (3d Cir. 1994)).

<sup>477</sup> *Bennett*, 9 F. Supp. 2d at 529.

<sup>478</sup> *Id.*

<sup>479</sup> *Id.*

<sup>480</sup> *See id.* at 524-27.

<sup>481</sup> *Id.* at 524. Downward departures for age are not commonplace. *See generally* Burrow & Koons-Witt, *supra* note \_\_\_ (discussing the applicability of downward departures based on age for the increasingly elderly population). The Burrow & Koons-Witt article notes that even though granting a downward departure based on age is within a judge’s discretion, many “balk” at the notion of decreasing a criminal’s sentence simply because they are elderly. *Id.* In fact, U.S.S.G. § 5H1.1 states:

Age (including youth) is not ordinarily relevant in determining whether a departure is warranted. Age may be a reason to depart downward in a case in which the defendant is elderly and infirm and where a form of punishment such as home confinement might be equally efficient as and less costly than incarceration. Physical condition, which may be related to age, is addressed at § 5H1.4 (Physical Condition, Including Drug or Alcohol Dependence or Abuse; Gambling Addiction).

U.S.S.G. § 5H1.1 (2008). Typically, this downward departure may be requested when a defendant is over the age of sixty. *Id.* at cmt. 3. In *United States v. Collins*, 122 F.3d 1297 (10th Cir. 1997), the appellate court



community ties or responsibility granted.<sup>482</sup> Third, Bennett’s employment record did not warrant a downward departure.<sup>483</sup>

In contrast to the three downward departures that were denied, three were also granted.<sup>484</sup> First, the court granted Bennett’s request for a downward departure based on prior good works.<sup>485</sup> Generally, the court should not consider a defendant’s “prior good works” when assessing a sentence.<sup>486</sup> However, where a defendant’s community service history includes “truly extraordinary circumstances,” the court can issue a downward departure.<sup>487</sup> Citing Bennett’s past as a drug-rehab counselor, manager, and charitable fundraiser, the court stated, “the evidence

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upheld a downward departure for a sixty-four year old male with heart disease, high blood pressure, arthritis, ulcers, and prostatitis. The *Collins* Court noted that judge’s may rely on these factors so long as they are “logically relevant” to the criminal history of the defendant. See generally *Collins*, 122 F.3d 1297. However, in *United States v. Marin-Castenada*, 134 F.3d 551 (3d Cir. 1998), *cert. denied* 523 U.S. 1144 (1998), the Third Circuit refused to grant a downward departure to a sixty-seven year old defendant simply because of his age. Because using age as a downward departure is discouraged under § 5H1.4, many courts will not grant such a request unless the defendant is elderly *and* has life-threatening health conditions.

<sup>482</sup> *Bennett*, 9 F. Supp. 2d at 524. Much like downward departures based on age, departures based on family and community ties and responsibility are generally discouraged factors for judges to consider. U.S.S.G. § 5H1.6 (2008). See generally Harvey Wallace & Shanda Wedlock, *Federal Sentencing Guidelines and Gender Issues: Parental Responsibilities, Pregnancy and Domestic Violence*, 2 SAN DIEGO JUSTICE J. 395 (1994). Section 5H1.6 states that “family ties and responsibility . . . are not ordinarily relevant in determining whether a sentence should be outside the applicable guideline range.” U.S.S.G. 5H1.6 (2008). To receive a downward departure based on family responsibility, the defendant’s family situation must be “extraordinary.” Wallace & Wedlock, *supra*. Although this is yet another undefined term with legal ramifications, it is clear that the courts refuse to extend the downward departure absent extreme circumstances. For example, in *United States v. Archuleta*, 128 F.3d 1446 (10th Cir. 1997), the appellate court reversed the lower court’s grant of a departure based on the defendant’s contention that she solely supported two children and cared for her elderly, ill mother. The court determined that these were not circumstances “so exceptional” that they constituted a downward departure. However, in *United States v. Roselli*, 366 F.3d 58 (1st Cir. 2004), the court granted a downward departure for family responsibility to a defendant convicted of tax fraud. The court determined that because the father of four children, two of which were afflicted with cystic fibrosis, was required to spend extraordinary amounts of time with his children in order to keep them healthy, a downward departure could be granted. *Roselli*, 366 F.3d at 369.

<sup>483</sup> *Bennett*, 9 F. Supp. 2d at 525.

<sup>484</sup> *Id.*

<sup>485</sup> *Id.*

<sup>486</sup> Marjorie A. Shields, *Downward Departures under Federal Sentencing Guidelines for Community Service*, 173 A.L.R. FED. 667 (2001).

<sup>487</sup> See, e.g., *United States v. Tocco*, 200 F.3d 401 (6th Cir. 2000), *reb’g denied*, 209 F.3d 935 (6th Cir. 2000); *United States v. Takai*, 945 F.2d 738 (9th Cir. 1991); *United States v. Strange*, 370 F. Supp. 2d 644 (N.D. Ohio 2005) (noting that the defendant’s charitable works and mostly law-abiding life was not enough for a downward departure).

demonstrated that defendant's civic, charitable and public service and his good works were exceptional."<sup>488</sup> Accordingly, the court granted this downward departure.

Secondly, the court granted a downward departure based on Bennett's "extraordinary cooperation and restitution."<sup>489</sup> Once Bennett realized the extent of the situation, he aided prosecutors and the trustees in recovering funds.<sup>490</sup> He quickly turned over his home and assets, and even the home he had given one of his daughters.<sup>491</sup> Based on Bennett's cooperation and the efforts of Trustee Arlin Adams and bankruptcy Judges Fox and Dalzell, the amount of loss was "reduced from over \$100 million to about \$20 million."<sup>492</sup> As a result of his cooperation, the court granted this downward departure.

Finally, the court granted a downward departure for Bennett's diminished capacity.<sup>493</sup> Numerous experts examined Bennett to determine his mental capacity, and many disagreed.<sup>494</sup>

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<sup>488</sup> *Bennett*, 9 F. Supp. 2d at 525.

<sup>489</sup> *Id.* This downward departure is based on U.S.S.G. § 5K1.1. It states:

Upon motion of the government stating that the defendant has provided substantial assistance in the investigation or prosecution of another person who has committed an offense, the court may depart from the guidelines.

(a) The appropriate reduction shall be determined by the court for reasons stated that may include, but are not limited to, consideration of the following:

- (1) The court's evaluation of the significance and usefulness of the defendant's assistance, taking into consideration the government's evaluation of the assistance rendered;
- (2) The truthfulness, completeness, and reliability of any information or testimony provided by the defendant;
- (3) The nature and extent of the defendant's assistance;
- (4) Any injury suffered, or any danger or risk of injury to the defendant or his family resulting from his assistance;
- (5) The timeliness of the defendant's assistance.

U.S.S.G. § 5K1.1 (2008). This substantial assistance must be truthful, and if the government believes that the defendant may be lying, a substantial assistance agreement may be properly avoided. *See, e.g.*, *United States v. Johnigan*, 90 F.3d 1332 (8th Cir. 1996); *United States v. Waldrip*, 948 F. Supp. 908 (D. Neb. 1996).

<sup>490</sup> *Bennett*, 9 F. Supp. 2d at 525.

<sup>491</sup> *Id.*

<sup>492</sup> *Id.*

<sup>493</sup> *Id.*

However, the court reasoned that because Bennett truly believed that he was doing good works and managed to convince others of his good intentions, he must have “been subject to some form of extraordinary distortion and, perhaps, significantly reduced capacity.”<sup>495</sup> Accordingly, Judge Ludwig reasoned that the request should be granted.<sup>496</sup>

### 3. Public Response

Throughout the sentencing period, Judge Ludwig accepted victims’ letters to assist him in determining the proper sentence for Bennett’s crimes.<sup>497</sup> The victims’ responses were far from uniform, and some advocated the maximum sentence while others quickly forgave Bennett’s misdeeds.<sup>498</sup> As previously mentioned, some donors lost faith in charity.<sup>499</sup> Others, such as former Secretary of the Treasury William Simon, did not lose faith and truly believed that Bennett meant to cause no harm.<sup>500</sup> Bennett’s pastor, C. Raymond van Pletzen, urged the court to go lightly on Bennett because he was not a “con man” and was “truly repentant” for his misdeeds.<sup>501</sup> Still others felt that, “No one who knows Bennett personally considered him a common criminal.”<sup>502</sup> Thus, taking into account the feelings of the victims involved, Judge Ludwig arrived at his decision.

### 4. Summary of Sentence Calculation

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<sup>494</sup> *Id.*

<sup>495</sup> *Id.*

<sup>496</sup> *Id.*

<sup>497</sup> *Id.*

<sup>498</sup> See generally Carnes, *Bennett ‘Dream’ Became ‘Delusion,’ supra* note 192 (discussing victim-impact letters).

<sup>499</sup> *Id.*; see Neff, *supra* note 194 (“[t]he New Era scandal that washed over America’s nonprofits in May has damaged the sense of trust that has developed through many years of ministry”).

<sup>500</sup> Carnes, *Bennett ‘Dream’ Became ‘Delusion,’ supra* note 192 (“Yet William E. Simon, the former Secretary of the U.S. Treasury and a New Era donor, said, ‘He believed he could match the funds he raised. I hope ... he will be given the opportunity to start anew.’”).

<sup>501</sup> *Id.* (discussing victim impact letters provided to the court).

<sup>502</sup> Frame, *The ‘Post-New Era’ Era: Ministries Band Together to Overcome Losses, supra* note 24 (noting that “[s]ome speculate that Bennett is ‘addicted’ to giving”).

Originally, Bennett faced up to 907 years in prison.<sup>503</sup> However, once he changed his plea from not guilty to nolo and substantially assisted the government, Bennett significantly lowered the amount of time he might have to spend in prison. Based on the Guidelines calculations submitted by the prosecution, Judge Ludwig could have sentenced Bennett to twenty-four years in prison.<sup>504</sup> However, as previously discussed, the court granted various downward departures. Thus, Bennett's sentence was calculated as follows:

The sentence enhancements and adjustments for defendant's role included:

- 18 additional levels for the amount of loss;
- 2 additional levels for “more than minimal planning;
- 2 additional levels for misrepresenting New Era as a charity;
- 4 additional levels for affecting the gross receipts of a financial institution in excess of \$1 million;
- 4 additional levels for being the leader of otherwise extensive criminal activity;
- and
- 2 additional levels for abusing a position of trust.

As such, Bennett was placed in a range of between 235 and 293 months imprisonment.<sup>505</sup>

However, Judge Ludwig “departed downward 91 months” based Bennett's prior good works, substantial assistance, and diminished capacity.<sup>506</sup> Accordingly, Judge Ludwig arrived at a sentence of 144-months.

**c. *United States v. Bennett*, 161 F.3d 171 (3d Cir. 1998).**

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<sup>503</sup> See *supra* note 398 and accompanying text.

<sup>504</sup> Carnes, *Bennett 'Dream' Became 'Delusion,' supra* note 192.

<sup>505</sup> *United States v. Bennett*, 161 F.3d 171, 179-85 (3d Cir. 1998).

<sup>506</sup> *Id.*

On appeal, Bennett raised two main issues: whether the court erred in its pretrial rulings concerning the admissibility of expert testimony<sup>507</sup> and whether the district court properly weighed the enhancement factors and downward departures in calculating an appropriate sentence.<sup>508</sup> Bennett had specifically reserved the second issue for appeal, from the first evidentiary hearing.<sup>509</sup>

### **i. Evidentiary Issues**

First, the Third Circuit addressed whether the district court correctly excluded expert testimony concerning Bennett's mental state.<sup>510</sup> Reviewing the district court's decision for abuse of discretion, Judge Scirica reviewed the confines of evidentiary rule 704.<sup>511</sup>

Bennett sought to introduce psychiatric evidence about whether he:

(a) harbored the specific intent to defraud; (b) knew and believed that the tax returns and other information given to the IRS were false; (c) knew the money he handled represented the proceeds of criminal activity (as is required under the money laundering statute); or (d) harbored the specific intent to promote illegal activity.<sup>512</sup>

After summarizing much of the lower court's reasoning, the appellate court held:

We believe the District Court properly excluded the questions asking whether Bennett's mental disorders (1) "precluded him from forming the intent to defraud"; (2) made it "highly unlikely that he could form the intent to defraud"; (3) made it "unlikely that he would have engaged in conduct designed to defraud"; (4) precluded him "from forming the specific intent to defraud individuals"; (5) made it "unlikely that he could defraud the individuals and entities"; (6) "affect[ed] his ability to knowingly and willfully submit false statements to the I.R.S."; and (7) made "it unlikely that he would knowingly and willfully submit false statements to the I.R.S." These questions go beyond merely assisting the jury, explaining the nature of Bennett's mental disease, or describing the typical effect of Bennett's disorders on his mental state. Instead, they require the expert witness to state expressly whether Bennett possessed the requisite intent to commit the crimes charged in the indictment. Accordingly, we find no abuse of discretion in the District Court's

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<sup>507</sup> *Id.*

<sup>508</sup> *See id.*, at 185-99.

<sup>509</sup> *Id.*

<sup>510</sup> *Id.* at 182.

<sup>511</sup> *Id.* (citing *United States v. McGlory*, 968 F.2d 309, 345 (3d Cir. 1992); *Habecker v. Copperloy Corp.*, 893 F.3d 49, 51 (3d Cir. 1990)).

<sup>512</sup> *Id.*

refusal to admit the questions.<sup>513</sup>

As such, the Appellate Court denied Bennett's request for reversal regarding the admissibility of expert testimony and upheld its precedent in *Pohlot*.<sup>514</sup> Ultimately, the court explained that Bennett sought to introduce evidence regarding how his mental disorders could affect his criminal culpability; however, the court determined that making such a determination is "exclusively within the province of the jury."<sup>515</sup> Accordingly, the Third Circuit affirmed the district court's determination to limit the psychiatric testimony.

## ii. Downward Departure Issues

Secondly, the court addressed Bennett's concerns about the sentencing issues.<sup>516</sup> The court began this portion of the opinion by noting that Fed. R. Crim. P. 32(c)(1) entitles the defendant to "comment" regarding the proposed sentence.<sup>517</sup> Bennett complained that because Judge Ludwig

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<sup>513</sup> *Id.*

<sup>514</sup> *Bennett*, 161 F.3d at 185 (discussing *United States v. Pohlot*, 827 F.2d 889 (3d Cir. 1987)). The court furthered explained:

*Pohlot* mentioned Rule 704(b), albeit briefly, in dicta: [T]he Senate Judiciary Committee wished to abolish only diminished responsibility and capacity defenses not to abolish the use of psychiatric evidence to disprove mens rea. A later portion of the Senate Report confirms this view of the Committee's intent. In addition to changing the insanity defense, the Insanity Defense Reform Act altered Federal Rule of Evidence 704 to prevent psychiatric experts from providing opinions on ultimate issues. The Report explained: "The Committee has fashioned its Rule 704 provision to reach all such ultimate issues, e.g., *premeditation in a homicide case*, or lack of predisposition in entrapment." Premeditation is, of course, an element of mens rea. If the Judiciary Committee had intended § 17(a) to prevent psychiatrists from testifying about mens rea at all, its report would almost certainly not have indicated its approval of psychiatric evidence on mens rea. *Id.* at 898-99 (citations omitted).

*Bennett*, 161 F.3d at 185 n. 17.

<sup>515</sup> *Id.* at 185.

<sup>516</sup> *Id.*

<sup>517</sup> *Id.* In its entirety, Fed. R. Crim. P. 32(c)(1) states:

(1) Sentencing Hearing. At the sentencing hearing, the court must afford counsel for the defendant and for the Government an opportunity to comment on the probation officer's determinations and on other matters relating to the appropriate sentence, and must rule on any unresolved objections to the presentence report. The court may, in its discretion, permit the parties to introduce testimony or other evidence of the objections. For each matter controverted, the court must make either a finding on the allegation or determination that no finding is necessary because the controverted matter will not be taken into account in, or will not affect, sentencing. A written record of these findings and

filed the Sentencing Memorandum *after* the sentencing hearing, the memorandum should not be considered.<sup>518</sup> The local rules provided that a judge may file an opinion within fifteen days of the hearing, however, Judge Ludwig filed his opinion well after the fifteen day limit.<sup>519</sup> Despite Bennett’s contention and citation of the local rules, the Third Circuit determined that Bennett was not prejudiced by the court’s review of the Sentencing Memorandum given that he had ample opportunity to respond to the document.<sup>520</sup> Accordingly, the Third Circuit reviewed the District Court’s Sentencing Memorandum for the factual findings.<sup>521</sup>

Finally, because the court found that the district court did not abuse its discretion in excluding specific questions, limiting expert testimony, and the court made “sufficient findings of fact” as required by the Rules of Criminal Procedure, the appellate court upheld the district court’s ruling.<sup>522</sup>

**d. Denial of Certiorari - *Bennett v. United States*, 528 U.S. 819 (1999).**

Although the Third Circuit ruled against Bennett, he did not go down without a fight.<sup>523</sup> On June 4, 1999, Bennett petitioned the United States Supreme Court for certiorari to determine two issues: (1) whether “a federal criminal offense ‘affected a financial institution’ within the

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determinations must be appended to any copy of the presentence report made available to the Bureau of Prisons.

Fed. R. Crim. P. 32(c)(1) (2008).

<sup>518</sup> *Bennett*, 161 F.3d 185-86 (discussing the local rule of appellate procedure regarding late filings).

<sup>519</sup> *Id.* at 186. The rule at issue states, in pertinent part:

At the time of the filing of a notice of appeal, the appellant shall mail a copy thereof by ordinary mail to the trial judge. Within 15 days thereafter, the trial judge may file and mail to the parties a written opinion or a written amplification of a prior written or oral recorded ruling or opinion.

*Bennett*, 161 F.3d at 186 (citing 3d Cir. R. 3.1).

<sup>520</sup> *Id.*

<sup>521</sup> *Id.*

<sup>522</sup> *Id.* at 198.

<sup>523</sup> See Petition for Writ of Certiorari To the United States Court of Appeals for the Third Circuit, *Bennett v. United States*, 528 U.S. 819 (1999) (No. 98-1957)

meaning of the 1990 Crime Control Act ... and the Financial Institutions Reform, Recovery and Enforcement Act ..., so as to trigger a substantial Sentencing Guidelines enhancement ... if the institution identified at sentencing was neither a victim nor a target of the offense” and (2) whether the principles on lenity and strict construction should be applied to interpretation of the Sentencing Guidelines.<sup>524</sup> However, as it does with so many cases, the United States Supreme Court denied certiorari, and the United States’ criminal case against Bennett came to a close.<sup>525</sup>

### 3. SEC v. Bennett

In addition to the bankruptcy proceedings and the criminal fraud proceedings, Bennett also faced charges from the SEC.<sup>526</sup> Tipped off from Meyer’s letter, the SEC filed suit against Bennett and New Era on May 18, 1995.<sup>527</sup> The SEC “charged Bennett with misusing \$55 million.”<sup>528</sup> In its petition, the SEC asserted that Bennett not only “diverted more than \$4 million to his own private businesses,” but that he also “paid himself an average of more than \$26,000 a week in consulting fees.”<sup>529</sup> Though Bennett ultimately was found guilty the following hearings ensued in the SEC’s case against the Ponzi scheme perpetrator.

#### a. Jurisdictional Hearing

On the same day that the SEC charged Bennett of the massive Ponzi scheme, the SEC petitioned the court to enter a proposed negotiated consent injunction.<sup>530</sup> The proposed consent

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<sup>524</sup> *Id.*

<sup>525</sup> *Bennett v. United States*, 528 U.S. 819 (1999). Bennett is currently serving his twelve-year sentence at Fort Dix in New Jersey. Litigation Release No. 15637, Securities and Exchange Commission (Feb. 5, 1998), *available at* <http://classaction.findlaw.com/cases/securities/sec/sec1/files/1998/lr15637.html>.

<sup>526</sup> *SEC v. Bennett*, 889 F. Supp. 804, 804 (E.D. Pa. 1995).

<sup>527</sup> *Bennett*, 889 F. Supp. at 804; *see also* Berger, *supra* note 75 (noting that by mid-May, the SEC indicted Bennett for fraud).

<sup>528</sup> Frame, *The ‘Post-New Era’ Era: Ministries Band Together to Overcome Losses*, *supra* note 24.

<sup>529</sup> *Id.*

<sup>530</sup> *Bennett*, 889 F. Supp. at 806.



injunction had three major aspects: (1) freezing the assets controlled or owned by Bennett,<sup>531</sup> (2) requiring an update of Bennett’s assets so the freeze could be effective, and (3) restraining Bennett from future violations of the Securities and Exchange Acts.<sup>532</sup> Upon reviewing the terms of the agreed upon consent order, the Honorable Anita B. Brody, Federal Judge for the Eastern District of Pennsylvania, determined whether the Ponzi scheme involved “securities,” thereby conferring proper subject matter jurisdiction with the district court.<sup>533</sup>

First, Judge Brody explained that the Securities and Exchange Acts confer jurisdiction upon federal courts when the alleged fraud involves a “security.”<sup>534</sup> Because “security” is a term of art, determining whether something meets the definition involves issues of both subject matter jurisdiction and substantive law.<sup>535</sup> “Unlike a merits determination, the jurisdictional inquiry in a federal question case asks not whether the ‘legal theory alleged is probably false,’ but only whether ‘the right claimed is so insubstantial, implausible, foreclosed by prior [court decisions] or otherwise completely devoid of merit as not to involve a federal controversy.’”<sup>536</sup> Noting that the “wholly insubstantial” standard is based in part of the adversary nature of court proceedings, Judge Brody explained that in New Era’s situation, the “adversary machinery [was] not functioning” because

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<sup>531</sup> Interestingly, the court noted that this did not include the assets of co-defendant New Era. *Bennett*, 889 F. Supp. at 806 n.1; *see also* Arenson, *supra* note 206 (noting that as of May 17, 1995, the Pennsylvania Attorney General planned to freeze New Era’s assets).

<sup>532</sup> *Bennett*, 889 F. Supp. at 806. The original version of the consent order also provided for living expenses and reasonable attorney’s fees for Bennett. *Id.* Although both the SEC and Bennett agreed to the amounts listed in the original order, Judge Anita Brody indicated that she may not approve of the agreed upon living expense amount. *Id.* As a result, these issues were severed from the negotiated consent order for an injunction against New Era and Bennett agreed to petition the court separately regarding those issues. *Id.*

<sup>533</sup> *Id.*

<sup>534</sup> *Id.* at 807.

<sup>535</sup> *Id.* (citing *Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236, 239 (4th Cir. 1988) (Powell, J.)).

<sup>536</sup> *Bennett*, 889 F. Supp. at 807 (quoting *Kulick v. Pocono Downs Racing Ass’n, Inc.*, 816 F.2d 895, 899 (3d Cir. 1987) (internal quotations omitted) (citing *Oneida Indian Nation v. County of Oneida*, 414 U.S. 661, 666 (1974) and *Bell v. Hood*, 327 U.S. 678, 682-83 (1946)).

Bennett agreed to the proposed negotiated order.<sup>537</sup> As such, issues concerning the substantive nature of the “security” were not submitted for review, and Judge Brody asked that the parties brief the court on whether the Ponzi scheme fit within the Securities and Exchange Acts’ definition of “security.”<sup>538</sup>

According to federal law, “‘security’ includes ‘notes,’ ‘investment contracts,’ and ‘other evidence of indebtedness.’”<sup>539</sup> The SEC contends that New Era’s Ponzi scheme fits within each of these subsections of security, thereby conferring jurisdiction with the federal court.<sup>540</sup> First, the court addressed whether the Ponzi fit within the definition of “note.”<sup>541</sup> Notes meet both the definition of “note” and “security,” but the “security” definition is narrower than “note.”<sup>542</sup> Based on a four-factor test from *Reves v. Ernst & Young*,<sup>543</sup> the SEC asserted, and Judge Brody agreed, that the instruments used in New Era’s Ponzi scheme were “notes” within the meaning of securities law.<sup>544</sup> The four-factor family resemblance test established by *Reeves* takes into account:

- (1) the motivations that would prompt a reasonable seller and buyer to enter into [a transaction],
- (2) the plan of distribution of the investment,
- (3) the reasonable expectation

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<sup>537</sup> *Bennett*, 889 F. Supp. at 807.

<sup>538</sup> *Id.* at 807-08.

<sup>539</sup> *Id.* at 808 (citing 15 U.S.C. § 77b(1); 15 U.S.C. § 78(c)(a)(10)).

<sup>540</sup> *Bennett*, 889 F. Supp. at 808.

<sup>541</sup> *Id.*

<sup>542</sup> *Id.* A “note,” as defined by Black’s Law Dictionary is “a written promise by one party (the *maker*) to pay money to another party (the *payee*) or to bearer. A note is a two party negotiable instrument, unlike a draft.” BLACK’S LAW DICTIONARY 868 (7th ed. 2000). A security, on the other hand, is:

The term ‘security’ means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a ‘security,’ or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.<sup>1</sup>

SEC v. W.J. Howey Co., 328 U.S. 293, 298 n. 3 (1946).

<sup>543</sup> 494 U.S. 56, 63-67 (1997).

<sup>544</sup> *Bennett*, 889 F. Supp. at 808.

of the public, and (4) whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument thereby rendering applications of the Securities Acts unnecessary.<sup>545</sup>

Thus, if an instrument is in the same “family” or “resembles” a security, it may be considered a security within the Securities and Exchange Acts. As such, the United States Supreme Court has adopted the “if it looks like a duck and quacks like a duck, then it will be considered a duck” approach to determining whether something is a security.

In applying *Reves*, the *Bennett* Court noted, “[f]irst, the SEC submits that New Era’s purpose in issuing the “notes” was to finance itself and that the various participants’ purpose was to profit from the 100% return assured by the notes.”<sup>546</sup> “Second, the SEC submits that the plan of distribution here was like that of a ‘security’ because hundreds of individuals and institutions in the United States were solicited by New Era and because over three hundred investors actually participated in New Era’s ‘matching’ program.”<sup>547</sup> “Third, the SEC submits that the public could reasonably expect that these notes were ‘securities’ because New Era described them as an ‘investment’ and because participants were told their funds were being placed at the well-known brokerage firm of Prudential Securities, Inc.”<sup>548</sup> “Finally, the SEC points out that there is no alternative regulatory regime that significantly reduces the risk of New Era’s ‘matching’ program and that renders application of the securities laws unnecessary here.”<sup>549</sup> As such, the court found that the Ponzi scheme involved “notes” within the definitions provided by securities law.<sup>550</sup>

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<sup>545</sup> American Bar Association, Committee on Business and Corporate Litigation, ANNUAL REVIEW OF DEVELOPMENTS IN BUSINESS AND CORPORATE LITIGATION 37 (2005 ed.)

<sup>546</sup> *Bennett*, 889 F. Supp. at 808.

<sup>547</sup> *Id.*

<sup>548</sup> *Id.*

<sup>549</sup> *Id.*

<sup>550</sup> *Id.*

In addition to finding that New Era sold “notes,” the court determined that New Era may have sold “investment securities” or engaged in “other evidence of indebtedness.”<sup>551</sup> The three-pronged test for determining whether something constitutes an “investment contract” is set out in *Securities & Exchange Comm’n v. W.J. Howey Co.*<sup>552</sup> “The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.”<sup>553</sup> In support of its contention that the New Era documents were investment securities, the SEC asserted three arguments: (1) participants “invested” money by placing it with New Era, (2) the deposited funds were a “common enterprise” because they “were pooled for a common purpose,” and (3) the proceeds of the matching funds program were “procured through ‘the efforts of others.’”<sup>554</sup> As such, the SEC alleged that the funds met the definition of “investment contracts” within the meaning of the Act, and Judge Brody agreed.<sup>555</sup>

Given the plethora of information submitted by the SEC regarding the nature of New Era funds as “securities” within the meaning of securities law, Judge Brody concluded that the “characterization of interests at issue here . . . surpasses *Kulick’s* ‘wholly insubstantial’ standard” and the district court had proper subject matter jurisdiction.<sup>556</sup> As such, Judge Brody noted the strong policy in favor of approving consent agreements unless they are “unfair, inadequate, or unreasonable.”<sup>557</sup> Because the proposed consent order was clearly a cooperative effort and

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<sup>551</sup> *Id.*

<sup>552</sup> 328 U.S. 293, 301 (1946).

<sup>553</sup> *Id.*

<sup>554</sup> *Bennett*, 889 F. Supp. at 808.

<sup>555</sup> *Id.* The SEC also provided the court with information regarding whether New Era’s “note-like instruments” were “other evidence of indebtedness.” *Id.* Although the court mentioned this assertion, it did not go into great detail regarding the assertion.

<sup>556</sup> *Id.* at 809.

<sup>557</sup> *Id.* (citing *SEC v. Randolph*, 736 F.2d 525, 527 (9th Cir. 1984); X. Louis Loss & Joel Seligman, *Securities Regulation* 4681 & n. 52 (3d ed. 1993); Thomas L. Hazen, *Administrative Enforcement: An Evaluation of the Securities and Exchange Commission’s Use of Injunctions and Other Enforcement Methods*, 31 *HASTINGS L.J.* 427, 450-51 (1979)).

Bennett understood the terms, the Judge approved the consent injunction and entered the order on June 12, 1995.<sup>558</sup>

### **b. Motion to Dismiss Hearing**

Following the negotiated consent order, Bennett filed a motion to dismiss based on lack of subject matter jurisdiction and failure to state a claim.<sup>559</sup> Ultimately denying both of Bennett's motions to dismiss, the court explained that questions remained concerning whether the interests invested in New Era were securities.<sup>560</sup> When dealing with rulings on motions to dismiss, the court must take the facts in the light most favorable to the non-moving party, and Judge Brody noted that Bennett failed to unequivocally show that the interests were not securities within the meaning of securities law.<sup>561</sup>

Although the court denied Bennett's 12(b)(6) motion, Judge Brody instructed the parties that if the issue regarding whether the interests were securities were to come up on appeal, the parties should address not only the "economic realities of the transaction," but also the precedential effect of making a ruling that these are securities.<sup>562</sup> Additionally, Judge Brody requested that the parties address the "possible impact on foundations that disperse charitable contributions to other charities of requiring them to register their instruments with the SEC."<sup>563</sup> Addressing these factors would take into account the economic realities of the situation.

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<sup>558</sup> *Bennett*, 889 F. Supp. at 808 ("The proposed consent injunction should be approved. It is not unfair or unreasonable on its face, and it is evidently the product of substantial negotiation between Mr. Bennett and the SEC. Moreover, Mr. Bennett's counsel represented at the May 18, 1995, conference that they had reviewed it carefully with Mr. Bennett and had advised him to sign it.").

<sup>559</sup> *SEC v. Bennett*, 904 F. Supp. 435, 436 (E.D. Pa. 1995).

<sup>560</sup> *Id.* at 436-37.

<sup>561</sup> *Id.* at 436 ("While a question may exist as to whether the instruments will ultimately qualify as securities under the securities law, I am unable to say at this point that this very stringent test has been met, therefore, I will allow the case to go forward and the parties to conduct discovery.").

<sup>562</sup> *Id.* at 436 (quoting *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558 (1979)).

<sup>563</sup> *Bennett*, 904 F. Supp. at 437.

Finally, the court addressed Bennett’s 12(b)(1) motion for dismissal, or, in the alternative, that the SEC should file a more definite statement.<sup>564</sup> Bennett asserted that the SEC “ha[d] alluded to theories of potential liability that [were] so set forth in its Complaint, [and] these theories [were] so vague and ambiguous that [Bennett could] not frame a responsive pleading.”<sup>565</sup> The court unsympathetically replied that Bennett failed to clearly point out the defects in the pleadings, thereby failing to comply with 12(e), which required Bennett to “point out the defects complained of and the details desired.”<sup>566</sup> As such, the court denied both of Bennett’s motions to dismiss and enabled the parties to proceed.<sup>567</sup>

**c. Final Judgment – SEC v. John G. Bennett, Jr. & the Foundation for New Era Philanthropy, 95 Civ. 3005, U.S.D.C. (E.D. Pa. 1998).**

On February 4, 1998, Judge Brody issued the Final Judgment of Permanent Injunction and Other Equitable Relief by Consent.<sup>568</sup> Based largely on the same findings of fact as in the criminal trial, the SEC alleged that “Bennett and New Era victimized hundreds of investors throughout the nation, and wrongfully solicited more than \$100 million . . . in 1995 alone.”<sup>569</sup> The final judgment enjoins Bennett from future violations of the securities acts.<sup>570</sup> Additionally, the court “orders Bennett to disgorge profits earned as a result of the conduct alleged . . . plus interest, in the total

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<sup>564</sup> *Id.*

<sup>565</sup> *Id.* (quoting Defendant’s Motion at ¶ 15).

<sup>566</sup> *Bennett*, 904 F. Supp. at 437.

<sup>567</sup> *Id.*

<sup>568</sup> Litigation Release No. 15637, *supra* note 525.

<sup>569</sup> *Id.*

<sup>570</sup> *Id.*

amount of \$3,424,015.<sup>571</sup> Despite the court’s order, the fees were waived, given Bennett’s inability to pay.<sup>572</sup>

#### **d. SEC’s fine against Prudential**

In addition to its case against Bennett, the SEC fined Prudential for its role and oversights in the New Era debacle.<sup>573</sup> The SEC assessed an \$800,000 penalty against Prudential for “failing to properly supervise the broker who handled New Era’s investment accounts.”<sup>574</sup> Additionally, the SEC fined Stuart P. Biachi, the broker handling New Era’s accounts, \$64,586, and assessed a \$15,000 fine against John C. Birch, Bianchi’s supervisor.<sup>575</sup> The SEC explained that Bianchi not only failed to miss warning signs, but also “willfully aided and abetted” Bennett’s scam.<sup>576</sup>

#### **4. Museum of Jewish History v. Bennett**

“On May 18, 1995, the Museum of Jewish History filed a class action complaint against the purported directors and officers of the Foundation for New Era Philanthropy, and its accountant.”<sup>577</sup> The plaintiff class alleged six violations: (1) Securities and Exchange Act violations, (2) Racketeer Influenced and Corrupt Organizations Act violations, (3) fraud, (4) fiduciary duty breaches, (5) negligence, and (6) Solicitation of Funds for Charitable Purposes Act violations.<sup>578</sup> However, once New Era’s bankruptcy petition had been converted from a chapter

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<sup>571</sup> *Id.*

<sup>572</sup> *Id.*

<sup>573</sup> Debra E. Blum, *Federal Agency Fines Prudential Securities \$800,000 in New Era Philanthropy Scandal*, CHRONICLE OF PHILANTHROPY, Feb. 8, 2001, available at GALE Document No. A147060737.

<sup>574</sup> *Id.*

<sup>575</sup> *Id.*

<sup>576</sup> *Id.* (“The commission said that Mr. Bianchi failed to tell investors that their money was not held in escrow or ‘quasi-escrow’ accounts, as they were led to believe. Investors were also not informed that New Era’s president, John G. Bennett, Jr., had borrowed money from Prudential using treasury bills purchased with investors’ money as collateral.”).

<sup>577</sup> *Museum of American Jewish History v. John G. Bennett, Jr., et al.*, 1995 U.S. Dist. LEXIS 7632 (E.D. Pa. June 2, 1995). In all, the complaint was filed against the following: (1) John G. Bennett, Jr., (2) Mary Sinclair, (3) Dr. John Brabner-Smith, (4) Vivian Weyerhaeuser Piasecki, (5) Dr. John M. Templeton, Jr., (6) Charles D. Fulton, (7) Dean Lind, and (8) John P. McCarthy and Co. *Id.*

<sup>578</sup> *Id.*

11 petition to a chapter 7 petition, the plaintiff class (led by the Museum of American Jewish History) filed a motion to withdraw because (1) the statute of limitations was unlikely run and (2) the trustee would be able to adequately protect the interests of the class, who were creditors in the chapter 7 case.<sup>579</sup> The Honorable Steward Dalzell of the Eastern District of Pennsylvania presided to determine whether to allow the Museum of American Jewish History to withdraw its complaint under Federal Rule of Civil Procedure 41(a).<sup>580</sup>

In his opinion, Judge Dalzell explained that the Museum understated the “palpable risk that the [t]rustee may not protect the creditors’ interests as the Museum sought to do as erstwhile class champion.”<sup>581</sup> The court noted that the trustee has the power to bring a suit on behalf of the creditors, but it also has the power to *not* bring a suit against New Era on behalf of the creditors.<sup>582</sup> Because the trustee would not be forced to bring an action against New Era’s management, Judge Dalzell voiced concern that the statute of limitations may run before members of the plaintiff class could assert a new claim against New Era.<sup>583</sup> Although Judge Dalzell made no suggestion as to whether to assert or abandon the claims, he “hope[d] to create a clearer legal landscape with

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<sup>579</sup> *Id.*

<sup>580</sup> *Id.* “Rule 41 generally allows plaintiffs to withdraw a complaint without court order ‘by filing a notice of dismissal at any time before service by the adverse party of an answer.’ *Fed. R. Civ. P. 41(a)(1)*. The rule is subject to *Rule 23(e)*, however, which counsels that “[a] class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.” *Fed. R. Civ. P. 23(e)*.” *Id.* at n.1 (emphasis in original).

<sup>581</sup> *Museum of American Jewish History*, 1995 U.S. Dist. LEXIS 7632.

<sup>582</sup> *Id.* (“We only wish to emphasize that the [t]rustee clearly has the power *not* to assert such claims against New Era’s management.”).

<sup>583</sup> *Id.*



respect to these claims for the putative class members, in fulfillment of our *Rule 23(e)* duty.”<sup>584</sup> As such, the court allowed a conditional dismissal of the class action against New Era.<sup>585</sup>

## 5. Messiah College v. Prudential

Although Bennett and New Era took the brunt of the heat from the fire caused by New Era’s Ponzi scheme, other institutions also found themselves thrown into the fire.<sup>586</sup> Many investors banded together to file a class action suit against Prudential for the lost investments.<sup>587</sup> “Documentation uncovered since New Era filed for bankruptcy establishes that Prudential ... and its employees acted inappropriately in using our funds to cover the exposure they had through their dealings with New Era and John Bennett.”<sup>588</sup>

In November 1996, thirty-three organizations filed suit against Prudential for its role in perpetuating New Era’s Ponzi scheme.<sup>589</sup> Rather than choosing to fight the “victims,” Prudential decided to settle the suit for \$18 million that would be added to the “pool of money going to reimburse New Era’s victims.”<sup>590</sup> This settlement agreement enabled victims to be able to likely recover 85-90 percent of lost investments, as compared to roughly 65 percent without Prudential’s settlement.<sup>591</sup>

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<sup>584</sup> *Id.* Fed. R. Civ. Pro. 23(e) provides: “[a] class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.” Fed. R. Civ. Pro. 23(e).

<sup>585</sup> *Id.* The court conditioned the dismissal on the grounds that “By June 23, 1995, the Museum of American Jewish history shall file a motion in *In re Foundation for New Era* ... that the Trustee elect to assert or abandon the claims that the Museum has brought against defendants in this action; and ... [n]otice to the class of dismissal of this action is not required.” *Id.* at \*6-7.

<sup>586</sup> Maxwell, *supra* note 46.

<sup>587</sup> *Id.*

<sup>588</sup> *Id.*; see *supra* Part III.b.4.d (discussing SEC fines against Prudential employees).

<sup>589</sup> *Prudential Settles New Era Suit; Investors Eye Larger Payback*, *supra* note 196.

<sup>590</sup> *Id.*

<sup>591</sup> *Id.*

## 6. United States v. Cunningham

On September 27, 1996, the government notified Andrew Cunningham that he would be charged with aiding and abetting Bennett on criminal wire fraud and aiding and abetting Bennett's breaking of IRS laws.<sup>592</sup> Rather than awaiting indictment, Cunningham pled guilty to the felony counts on October 15, 1996.<sup>593</sup> Cunningham was sentenced to thirty months imprisonment followed by three years of supervised release.<sup>594</sup> Upset by the length of his sentence, Cunningham appealed to Judge J.C. Joyner for a downward departure based on his "substantial assistance."<sup>595</sup> Judge Joyner granted Cunningham's motion for a downward departure on January 15, 1998.<sup>596</sup>

### V. Lessons Learned

As Ralph Nader once said, "Your best teacher is your last mistake."<sup>597</sup> Perhaps a positive outlook on the Ponzi scheme would simply encourage investors (and potential investors) to learn from the mistakes of the 1,100 charities and non-profits that invested with New Era. This Part discusses various lessons that should be not only learned from the New Era debacle, but also followed.

#### a. Just Because Someone Is Popular Doesn't Mean You Should Swoon.

One of the most notable aspects of Bennett's scam was his "clientele." As one observer noted, "it's quite clear that victims of scams are not just little old ladies. A recent [American Association of Retired Persons] survey found most victims of scams are well-educated, have

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<sup>592</sup> PACER Criminal Docket for Case #2:96-cr-00507-JCJ-1 (USA v. Cunningham).

<sup>593</sup> *Id.*

<sup>594</sup> *Id.*

<sup>595</sup> *Id.*

<sup>596</sup> *Id.*

<sup>597</sup> Thinkexist.com, Ralph Nader Quotes, [http://thinkexist.com/quotation/your\\_best\\_teacher\\_is\\_your\\_last\\_mistake/224736.html](http://thinkexist.com/quotation/your_best_teacher_is_your_last_mistake/224736.html) (last visited April 20, 2008).

above-average intelligence, and are socially active. Anyone can be a victim.”<sup>598</sup> Such statement proved true with New Era. Bennett swindled financially savvy contributors such as Laurence Rockefeller, Harvard University, former United States Treasury Secretary William Simon, and even the well-known investor John Whitehead.<sup>599</sup> These big name participants lent credibility to Bennett’s scheme and encouraged less sophisticated contributors to invest.<sup>600</sup>

“Bennett passed muster with so many people we looked up to [that] we didn’t let these questions cause us to withdraw.”<sup>601</sup> Even though many were initially hesitant to invest, people became much more comfortable once the initial investors were paid back. Robert Andringa, president of the Coalition for Christian Colleges and Universities, stated that “attorneys and auditors said [the matching program] was unusual and that they can’t give it a clean bill of health.”<sup>602</sup> Despite their concerns, the Coalition still invested \$350,000 with New Era, based, in some part, on the list of investors.<sup>603</sup>

Though investors usually make decisions individually, this seems like the old problem of “groupthink.” Groupthink occurs when individuals who are surrounded by a group do not want to “upset the herd,” so rather than voicing objections or concerns, they simply go along with the group’s decision.<sup>604</sup> Once others back a charity, they continually give more credibility to its cause. As one commentator noted of Jim Bakker’s PTL scheme: “The PTL scandal exhibited several

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<sup>598</sup> See Spencer, *supra* note 7.

<sup>599</sup> Chernow Interview, *supra* note 3.

<sup>600</sup> See also *id.* (“I mean, the names seemed to be absolutely unimpeachable, and these were all people [who] are renowned in the business world for the care and the shrewdness with which they invest. The amazing question is why that shrewdness was not applied when it came to this foundation and how they could have been so gullible.”).

<sup>601</sup> Giles, *supra* note 20 (quoting Peter Sorensen, a Zacharias Ministries board member).

<sup>602</sup> *Id.*

<sup>603</sup> *Id.*

<sup>604</sup> Gia B. Lee, *The President’s Secrets*, 76 GEO. WASH. L. REV. 197, 235 (2008) (“Groupthink delineates a set of conditions and processes that leads groups toward an ‘extreme consensus-seeking’ tendency and thereby interferes with critical thinking. Though unintentional and unacknowledged, the tendency causes “a deterioration of mental efficiency, reality testing, and moral judgment.”).

possible symptoms of groupthink, such as belief in the group's inherent morality, rationalizations, stereotyping adversaries, and pressures to conform.”<sup>605</sup> Similarly to victims of the PTL scandal, investors quickly jumped to invest in New Era because New Era initially paid such incredible returns and had a stellar list of investors. Had individual organizations stopped to evaluate the investment, perhaps the smooth-talking salesman would have taken in fewer victims.

**b. Exclusivity Does Not Mean Awesome Opportunity.**

In the New Era Ponzi early days, Bennett was exclusive as to who he would allow to participate. In the beginning, investors had to be “invited.” This exclusivity intrigued many investors. Once New Era followed through on the original returns, the exclusivity attracted even more potential investors. In fact, investors who were lucky enough to be involved in the funds matching program became wary of angering Bennett. As previously mentioned, investors were encouraged to not ask questions. As such, Bennett held a certain power over previous investors.

Perhaps some investors feel reminiscent about the days in middle school in which they feared not being chosen for a dodge-ball team, but investors should remember that exclusivity does not always mean that an opportunity is legit. In a Forbes article about swindlers, the author notes “irresistible to babes in the financial woods, [is the notion] that there are invincible deals out there available only to the big, sophisticated investors.”<sup>606</sup> Once investors are given the opportunity to be a part of the “in-crowd,” they tend to throw caution to the wind.

**c. Documentation is Key.**

“[A]nyone handing over money to an outside organization should demand to see audited financial statements. And if money is handed over to a matching grants program, participants

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<sup>605</sup> Rusty Wright, JFK and Groupthink: Lessons in Decision Making, Probe Ministries, 2003, <http://www.probe.org/content/view/full/1088/162/> (last visited Apr. 10, 2008).

<sup>606</sup> Dan Seligman, *Swindles of the Year*, FORBES, June 14, 1999, at 278.

should get documentation that the funds are held in escrow.”<sup>607</sup> Albert Meyer warns, “There is simply no substitute for certified, audited financial statements.”<sup>608</sup> Meyer’s warning is well-placed. It is often noted that transparency in financials is an integral part of evaluating investments.<sup>609</sup> When an organization refuses to release records to potential investors, a warning light should go off for all investors. As previously mentioned, Bennett refused to provide investors with any information in addition to what was contained in the binder. This could be for a variety of reasons—perhaps Bennett’s financial statements were not up to par or, more likely, Bennett did not prepare any financial statements. In either situation, the lesson is the same. Investors should carefully evaluate the available financial information, and if the necessary information is not readily available, *demand* it.

Perhaps as a warning to those who have given Jim Bakker a second chance, this is an important lesson. Upon a request for audited financial statements, Professor Steven Wizenburg received a letter stating, “it means so much to Lori and me to hear from our friends. . . . We want to be a blessing to you!”<sup>610</sup> What is glaringly omitted from the Bakkers’ response to Professor Wizenburg’s request is the financial statement or any direction as to how to obtain such information. Accordingly, investors and contributors may seek to demand more information

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<sup>607</sup> Demery, *supra* note 146.

<sup>608</sup> Frame, *The ‘Post-New Era’ Era: Ministries Band Together to Overcome Losses*, *supra* note 24 (noting that Meyer supports the notion that “audited statements should be considered standard due-diligence procedure”).

<sup>609</sup> See generally Enrico C. Perotti, *Dominant Investors and Strategic Transparency*, 21 J.L. ECON. & ORG. 76, 76 (2005) (“Poor transparency has been widely advanced as a cause of financial vulnerability in emerging economies, following the Asian crisis.”); Arthur Levitt, Chairman, SEC, *The Importance of Transparency in America’s Debt Market* (Sept. 9, 1998) available at <http://www.sec.gov/news/speech/speecharchive/1998/spch218.htm> (“Transparency is critically important in a number of ways. . . . For securities markets, transparency is the extent to which timely data on prices are visible and understandable to all participants. At various times, some market participants have resisted efforts to increase the availability of information to investors. But experience has proven, and again, that transparency – to borrow from President Kennedy – is a tide that lifts all boats.”); Ben McClure, *Show and Tell: The Importance of Transparency*, INVESTOPEDIA, available at <http://www.investopedia.com/articles/fundamental/03/121703.asp> (“When financial statements are not transparent, investors can never be sure about a company's real fundamentals and true risk.”).

<sup>610</sup> Steven Wizenburg, *TV Ministries Use of Air Time*, 2004, [http://faculty.gvc.edu/swizenburg/tv\\_ministries\\_study.pdf](http://faculty.gvc.edu/swizenburg/tv_ministries_study.pdf).

#### **d. Investigate when Things Seem “Fishy”**

“Peter Dorbin, the Inquirer feature writer who wrote the April 16 story, said he heard ‘plenty of innuendo’ about the foundation. ‘There was no shortage of people who said this smells fishy,’ he said. ‘What this story was short on was people who had facts.’”<sup>611</sup> As one of Jim Bakker’s previous employees said after the fact, “We were wrong. I should have refused the kind of salary I took . . . . We were so caught up in God’s work that we forgot about God. It took the tragedy, the kick in the teeth, to bring us to our senses.”<sup>612</sup> As this quote indicates, early warning signs were clearly in place, but people – both inside and outside of the organization – chose to ignore them.

Be wary when an organization requires funds to be deposited directly with the firm. New Era required that the deposits be placed directly with the institution rather than an autonomous third-party or escrow.<sup>613</sup> Although New Era explained this “requirement” by stating that it used the interest earned on the investments to cover day to day expenses, the interest earnings were not reported on New Era’s tax returns.<sup>614</sup> This type of behavior seems “fishy.”

#### **e. Research!**

The SEC website has numerous warnings about possible scams.<sup>615</sup> Investors should check the North American Securities Administrators Association’s (NASAA) Top 10 List of Frauds.<sup>616</sup> As of 2004, the number 1 on the Top Ten List of Frauds was Ponzi schemes, and number 5 was

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<sup>611</sup> Kurtz, *supra* note 609.

<sup>612</sup> Wright, *supra* note 605.

<sup>613</sup> Giles, *supra* note 20 (“Barry Gardner, a financial consultant who investigated New Era, said he heard ‘alarm bells’ over the requirement that money be placed under New Era’s control.”).

<sup>614</sup> *Id.* (“according to the group’s 1993 tax return, New Era earned a slim \$33,788 on \$41.3 million in contributions”).

<sup>615</sup> Spencer, *supra* note 7.

<sup>616</sup> *Id.*

affinity group frauds.<sup>617</sup> Such frauds are schemes with a religious, professional, or ethnic focus and the “fundraisers” claim to intend to help those groups.<sup>618</sup> Both federal and state governments have tried to educate investors regarding Ponzi.<sup>619</sup> For example, the NASAA’s website contains an

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<sup>617</sup> *Id.* The list included: (1) Ponzi Schemes; (2) Senior Investment Fraud; (3) Promissory Notes; (4) Unscrupulous Brokers; (5) Affinity Fraud; (6) Insurance Agent Securities Fraud; (7) Prime Bank/High-Yield Investment Schemes; (8) Internet Fraud; (9) Mutual Fund Business Practices; and (10) Variable Annuities. See Deborah Bortner, *Top Ten Frauds*, WASH. STATE DEPT. OF FINANCIAL INSTITUTIONS, Jan. 14, 2004 available at [http://www.dfi.wa.gov/sd/toptenfrauds\\_nr.htm](http://www.dfi.wa.gov/sd/toptenfrauds_nr.htm).

<sup>618</sup> Spencer, *supra* note 7.

<sup>619</sup> See generally North American Securities Administrators Association, Home Page, 2008, <http://www.nasaa.org/home/index.cfm>. This website provides helpful information such as the following section titled “Behind the Return of a Ponzi Scam:”

**Variety and Confusion**□ Though the Ponzi scheme has been around for 89 years, it is more prevalent today than ever before. The driving force behind this renaissance of the Ponzi swindle is the recent explosion of financial services and often bewildering new investments available to the public. In this crowded and fast-changing marketplace, Ponzi promoters have an increasing number of “costumes” at their disposal with which to dress up their schemes and thwart detection. Ponzi scams can involve almost any type of deal – generic drugs, clothing brokerages, hydroponics, windmills, gold mines, diamonds, precious metals, foreign currency transactions, commodities, high-tech stocks or speculative real estate

**Greed**□ The Ponzi scheme thrives on greed, which appears to explain why there always seems to be a ready supply of investors eager to turn over their life savings. Rather than investing for the future, victims are urged to cash in on a quick speculative scheme. Conservative, straight as an arrow investors sometimes get caught up in Ponzi schemes after promoters dangle high rates of return such as 18-20 percent over their heads.

**A “Surefire Scheme”**□ The bottom line of the Ponzi scheme is always the same: the attractive above-market rate of return on your investment is guaranteed. Investors are lulled by the nonsensical proposition that their investment is not at risk.

**The Herd Instinct**□ Frequently, Ponzi scam promoters rely completely on word of mouth to line up new investors. To get this process going, the con operators often concentrate their initial efforts on specific cities, types of investors, family members, church groups, professionals and social acquaintances. This initial stage of the scheme has zeroed in on members of specific pro football teams, Air Force bases and even law offices. This concentration on close knit groups often yields the desired result: Initial victims unwittingly aid the swindler by lining up their closest friends, relatives and professional associates as new victims.

**The Appearance of Success**□ Some initial investors in Ponzi scams are paid off handsomely, and often with returns considerably higher than those originally promised. Frequently, this is the “hard” proof that skeptical investors insist on seeing before they will jump in with both feet.

**Fear**□ Even as a Ponzi scheme starts to collapse, investors are slow to admit that they’ve been swindled. Frequently, there is the fear that public exposure will create a crisis of confidence that could create a run on the promoter and make things worse. There is also the fear of looking foolish for being blinded by greed. The investor may fear that if his suspicions are wrong, he will be drummed out of the high-interest scheme. And since the Ponzi scheme relies on a sense of community, there is the fear that the first investor who breaks ranks will be blackballed in his professional or social circles.

**The Tooth Fairy Syndrome**□ Investors in Ponzi schemes frequently cling to even the faintest of hopes that everything will work out for the better. Even after Charles Ponzi was exposed, for

audio recording entitled “Detecting and Avoiding Ponzi Schemes.”<sup>620</sup> The website also provides lists of questions to ask, tips to protect yourself from conmen, and provides the “Investor’s Bill of Rights.”<sup>621</sup> Perhaps even more helpful than the questions to ask or the Bill of Rights are the warning signs for various scams. The website specifically provides warning signs to look for in potential Ponzi schemes.<sup>622</sup> It states:

Here are basic rules to follow in steering clear of Ponzi schemes:

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example, investors continued to press their funds on him, believing that his new global investment syndicate would set everything straight. As one recent Ponzi scheme victim explained, “It was like believing in the tooth fairy. I didn’t want to give up on the whole deal.” This brand of thinking has resulted in investors attacking government officials and defending Ponzi promoters as heroes, saints and misunderstood financial geniuses with basically good intentions. Frequently, an exposed Ponzi operator will capitalize on these sentiments by stating that he got in over his head, telling investors that he meant well, but that things just got out of hand. Or the Ponzi promoter may vow to make good in one last venture, which may turn out to be nothing more than yet another Ponzi scheme.

*Id.* Thus, the NASAA provides lists of warning signs and the recipe for the textbook Ponzi. Investors should review this information prior to trusting others with their money.

<sup>620</sup> *Id.*

<sup>621</sup> *Id.* The Investor Bill of Rights states:

**When You Invest, You Have the Right to:**

**Ask** for and receive information from a firm about the work history and background of the person handling your account, as well as information about the firm itself.

- Receive** complete information about the risks, obligations, and costs of any investment before investing.
- Receive** recommendations consistent with your financial needs and investment objectives.
- Receive** a copy of all completed account forms and agreements.
- Receive** account statements that are accurate and understandable.
- Understand** the terms and conditions of transactions you undertake.
- Access** your funds in a timely manner and receive information about any restrictions or limitations on access.
- Discuss** account problems with the branch manager or compliance department of the firm and receive prompt attention to and fair consideration of your concerns.
- Receive** complete information about commissions, sales charges, maintenance or service charges, transaction or redemption fees, and penalties.
- Contact** your state or provincial securities agency in order to verify the employment and disciplinary history of a securities salesperson and the salesperson’s firm; find out if the investment is permitted to be sold; or file a complaint.

*Id.*

<sup>622</sup> *Id.*



**Beware promises of high, guaranteed profits.** This is perhaps the easiest way to spot a Ponzi scam. Any legitimate investment involves a degree of risk that makes it impossible to flatly promise profits, much less astronomical returns.

**Avoid promoters who fail to provide clear and detailed explanations.** Don't listen to promoters who tell you that it is impossible to explain their deal in layman's terms. Many investors fail to seek even the most rudimentary basic understanding of the investment they are making.

**Check out the promoter's background.** Check with your state, provincial, or territorial securities office for licensing/registration of the individuals selling the investment. Remember, anyone selling a security must have a license. If the promoter says he's exempt, follow-up with your regulator to confirm the claim.

**Get information from your state or provincial securities regulator.** Since most Ponzi schemes involve investment contracts, they should be registered as securities offerings with your state, provincial, or territorial securities division. If the promotion appears to be in violation of state securities law, turn over all information on the case in your possession to securities regulators.

**Ask for detailed information in writing.** Any investor is within his rights when insisting on detailed information from a promoter seeking large sums of money. Ask for information on the company, its officers and financial track record. If a product is involved in the deal, ask for documentation on its cost, fair market value, and existing and potential markets. Frequently, Ponzi promoters rely on nothing more than fast talk and official-looking promissory notes when investors sign over their funds. Reluctance to provide detailed information should be regarded as a red flag of a potential Ponzi scheme.

**Verify the promoter's claims.** Remember that seeing is believing. Be skeptical of deals that can't be checked out in person. When it comes to checking on details of your investment, be particularly leery of claims that all banking transactions and bookkeeping are handled in remote cities or other countries. Searching the internet is another way to verify the investment deal. If you do not have a home computer, your local library has internet access available to the public. Investors are sometimes told that certain information is being kept "secret" for security purposes.

**Resist pressure to reinvest without seeing your "profits."** Ponzi schemes often are kept going for substantial periods of time by promoters who convince even initial investors to roll-over their "profits" for even greater returns. While it frequently makes sense to stay with a legitimate investment over time, be suspicious of promoters who are reluctant to let you cash in your gains.

**Look for unbusiness-like conduct or disruption of services.** Reluctant to have their schemes exposed, few Ponzi operators enlist much, if any, office help, and may even go to the extreme of answering the phone and opening all the mail themselves. This has the effect of hastening the collapse of the Ponzi scheme, since it makes it even more difficult for one person to keep up with all the required payments and

investor contacts. And when the Ponzi bubble is about to burst, promoters typically become extremely difficult to reach.<sup>623</sup>

These resources are freely available to the public and should be utilized. If investors are skeptical about a particular investment, they should use the resources listed on the website to ask someone who is more knowledgeable about potential schemes.

**f. Old Habits Die Hard – Beware of Bennett upon Release.**

As the old adage goes, “old habits die hard.” If someone is accustomed to doing something one way, convincing them to do it another way may prove difficult. Though no concrete evidence is available stating that Bennett has not “rehabilitated” himself while in prison, investors should be wary of him upon his release. Although this may seem like common sense, apparently investors are not quick to learn.

For example, take Jim Bakker’s incredible story. He served years in prison.<sup>624</sup> During his time served, Bakker wrote a book entitled *I Was Wrong: The Untold Story of the Shocking Journey from PTL Power to Prison and Beyond*, in which he details how sorry he is for the scam.<sup>625</sup> However, his actions seem quite different from his apologetic book. Shortly after his release from prison, Bakker returned to the air on *The Jim Bakker Show*.<sup>626</sup> One might think that Bakker would choose a different angle given how many investors he burned with the PTL scandal, but he did not.<sup>627</sup> He continues his televangelism, and, perhaps even more shockingly, his fundraising.<sup>628</sup> Though

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<sup>623</sup> *Id.* at [http://www.nasaa.org/Investor\\_Education/Investor\\_Alerts\\_\\_\\_Tips/8315.cfm](http://www.nasaa.org/Investor_Education/Investor_Alerts___Tips/8315.cfm).

<sup>624</sup> Wizenburg, *supra* note 610.

<sup>625</sup> See generally Jim Bakker, *I WAS WRONG: THE UNTOLD STORY OF THE SHOCKING JOURNEY FROM PTL POWER TO PRISON AND BEYOND* (1997).

<sup>626</sup> Wizenburg, *supra* note 610.

<sup>627</sup> See generally *id.*

<sup>628</sup> *Id.*

Bakker was banned from fundraising during his probation, as soon as the restriction was lifted, he quickly began seeking donations.<sup>629</sup>

He resorts to statements similar to those he used while doing the “PTL Club” 25 years earlier, such as “Our ministry is going through life and death and we only have a few hours left” or “I’m fighting the worst battle of my life today” or “We need a miracle desperately . . . I need 1000 people to give \$100 to keep us alive.” He has come up with gimmicks like the “debtbusters club” and is selling little crystal crosses for \$25. In one fundraising segment he was filmed outside on a hill of rocks, showing how he couldn’t move himself. The[n] he later brought a pile of ricks into the studio and proved to people he needed their help to move them. He offers excuses such as “I’ve had a hard time raising money because of the past” or “I’ve been grieving so much over our problems I’ve been physically ill.” Instead of seeing himself as causing a problem, he sees the lack of viewer support as being the problem.

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Ironically, Bakker loves to complain about “arrogant, ego-centric” believers, yet he fails to see that almost every time he opens his mouth it’s to either proclaim a unique revelation God has given him or to coerce others into getting him out of the financial messes he gets himself into. While claiming to be Christ-centered, the program is really Bakker-centered. For his 65<sup>th</sup> birthday he spent 15 minutes reading from his book “I Was Wrong” (bragging of the surprise birthday party his fellow convicts gave him that included stolen food) before offering the book to viewers for a “birthday gift” contribution of \$65. He uses a type of false modesty to ask for money by proclaiming, “I didn’t think anybody’d watch Jim Bakker again” with a tear in his eye while bragging that a station owner told him Bakker’s show is the second-highest rated on the station. His words may reflect a bit more humility, but the attitude is still very self-serving.<sup>630</sup>

Amazingly, the Jim Bakker show is still on air and surviving.

Thus, even though it may seem like common sense to doubt Bennett if he attempts to return to philanthropic fundraising after his prison term, perhaps contributors should be reminded. As is evidenced by the Bakker example, the “forgive and forget” philosophy is

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<sup>629</sup> *Id.*

<sup>630</sup> *Id.* (“Despite prison promises to change, Bakker has unfortunately returned to his old bad habits. His major flaw is that he builds a ministry on credit, then he expects viewers to bail him out. In one particularly embarrassing episode of the show, Bakker had a huge display board of all the cities in America where the show airs, with the amount needed to stay on the air in each city and the number of people who had contributed. In some cities he had only two contributors! This is a man who gets himself into deep debt under the guise of God calling him to expand the ministry, then he harasses viewers for not supporting him. Bakker has not learned his lesson even after years in prison.”).

alive and well among philanthropic investors. However, investors should be wary of making the same mistake twice. As another old adage goes, “fool me once, shame on you; fool me twice, shame on me.”

**g. If it sounds too good to be true, it probably is.**

Ultimately, the lesson is this – if something sounds too good to be true, it more than likely *is* too good to be true. “Anyone who tells you that you can make huge amounts of money with very little investment, very little risk and very little work, is almost certainly not telling you the truth.”<sup>631</sup> “[T]here are no guarantees [in life] and high rewards only come with high risk.”<sup>632</sup> Bennett offered extremely high rates of return to investors. However, “[m]ost legitimate businesses cannot sustain levels of profitability required to service and retire Ponzi scheme capital.”<sup>633</sup> Such was clearly the case with New Era.

As with all Ponzi schemes, Bennett needed ever increasing amounts of capital to perpetuate his plan. By paying off the initial wave of investors with the funds obtained from the secondary wave of investors and so on, this plan worked for far too long. Investors should have researched the “investments.” Bennett told investors that the funds were “invested” in t-bills that were held by Prudential. However, t-bills offer nowhere near the returns that Bennett promised investors. He tried to explain this inconsistency by stating that the anonymous donors pledged to “match” the donations. However, even charitable donors have a limit. Bennett never explained the “cut off” for the anonymous donors. As such, these gaps in information should have signaled to investors that something seemed “fishy.”

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<sup>631</sup> Spencer, *supra* note 7.

<sup>632</sup> Stein, *supra* note 1.

<sup>633</sup> P. O’Keefe, R. Long & M. McElwee, *Surviving the Swindlers*, MICH. LAWYERS WEEKLY, Jan. 21, 2008.

“For harried development directors and ministry leaders, New Era was a dream come true – until, just three years after its promising beginnings, the dream became a nightmare.”<sup>634</sup> “We can all remember that nothing worthwhile comes easy.”<sup>635</sup> Although many failed to read the warnings, at least one potential investor chose to not invest with New Era because he did not understand the economics involved in New Era’s funds matching program.<sup>636</sup> When the New Era Ponzi unraveled, Mr. Scott responded by saying, “Holy cat . . . Isn’t it wonderful we were too stupid to participate? My God, it’s astonishing. Originally when we looked at it, we didn’t understand the economics, and therefore, when we don’t understand something, we tend to avoid it.”<sup>637</sup> Ironically, Mr. Scott’s “stupidity” saved him from becoming one of Bennett’s victims.

Perhaps investors should always ask themselves why someone would offer them such an amazing deal. If the deal is “exclusive” and only those who are chosen are entitled to participate, perhaps the investor should ask himself why he was chosen. If the deal returns are so incredible, why does the offerer of the fabulous returns need *you* rather than another donor to invest? Though this may seem like a very skeptical question to ask oneself, skepticism may be well-placed when determining where to invest your money.

Interestingly, evangelicals and Christian philanthropies sought religious reasons to continue giving.<sup>638</sup> As Steve Wulf, a journalist with *Time* magazine, noted, “Bennett’s secret was that he was

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<sup>634</sup> Neff, *supra* note 194.

<sup>635</sup> *Id.*

<sup>636</sup> Peter Dorbin, *Philadelphia Story in His Own Right*, *The Philadelphia Inquirer*, Oct. 14, 2005, at A1, *available at* 2005 WLNR 16653857 (discussing Robert Montgomery Scott’s apprehension of investing with New Era).

<sup>637</sup> *Id.* Mr. Scott was a “father figure” to Philadelphia’s “cultural community for several decades.” *Id.*

<sup>638</sup> *See generally* Neff, *supra* note 194 (discussing how to restore the “atmosphere of trust”). Neff’s article encourages donors to not lose faith in philanthropy because “ministry always requires risk.” *Id.* To support his proposition, he cites the Book of Acts and the stories of Adoniram Judson, David Brained and Jim Elliott. *Id.* Additionally, Neff urges donors to remember that the *Lord’s* money was lost – not the *individual donor’s*. *Id.* “To pull back from giving as a result of the New Era debacle would be to act like the lazy, fearful servant who buried his talent.” *Id.* Neff also reminded Christians to not think of those who invested in New Era as “fools,” because they were blinded by their “love and concern.” *Id.* Finally, Neff reminds donors that many of the institutions that invested in New Era were

able to marry two powerful but seemingly contradictory human instincts: greed and charity.”<sup>639</sup>

Greed is a key factor in perpetuating a Ponzi because the desire to obtain the high rates of return blinds investors to questioning the investment. “Ponzi schemes have a larcenous elegance.

They’re kind of financial alchemy, promising to turn basic human impulses like greed, trust, and fear into piles of cash.”<sup>640</sup> As two scholars have explained:

A Ponzi operator’s pitch to investors will typically not withstand even the most perfunctory due diligence by the investor. Therefore, the key for the Ponzi operator is to get people to invest without asking too many questions.

To accomplish this, the Ponzi operator will typically do two things – first, offer extremely high rates of return, then actually pay such returns to earlier investors. This creates a level of temptation (the so called “greed-factor”) that is exploited to assure a steady stream of new investors. A Ponzi operation will therefore usually involve extremely high rates of return over short periods of time and at least an initial pool of lucky investors who actually rake in these high returns.<sup>641</sup>

As such, Bennet’s New Era plan was a classic Ponzi scheme. Had investors realized this, perhaps the scheme would not have gotten as out of hand as it did. Accordingly, investors should avoid letting the greed factor blind them from seeing the obvious.

## VI. Conclusion

Perhaps John G. Bennett will simply become another Jim Bakker. The lack of outrage about the supposedly philanthropic organization duping millions of investors is nothing short of amazing. But Christian investors and philanthropists continually follow the “turn the other cheek” philosophy and come back for more.<sup>642</sup> As one investor opined, “[i]t’s better to be in the game

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relying on the double-funds promised for certain projects. *Id.* The failing pyramid “seriously curtailed” some of the initiatives that had been set in motion. *Id.*

<sup>639</sup> Wulf, *supra* note 21.

<sup>640</sup> Walsh, *supra* note 70.

<sup>641</sup> P. O’Keefe, R. Long & M. McElwee, *supra* note 633.

<sup>642</sup> The “turn the other cheek” philosophy is the New Testament method of dealing with an aggressor. In the famous “Sermon on the Mount,” Jesus told Matthew:

You have heard that it was said, ‘An eye for an eye, and a tooth for a tooth.’ But I tell you, do not resist an evil person. If someone strikes you on the right cheek, turn to him the other also. And if

and take your risks than not to be in the game at all.”<sup>643</sup> Some investors have not given up faith: “as Christians we dare not become cynical [and] we must continue to trust each other. We must believe that our yes means yes and our no means no.”<sup>644</sup> “Bennett still asserts that he never stole anything and he says he retains a sincere Christian faith.”<sup>645</sup>

Regardless of what individual victims or investors may feel, it seems as though a lesson from Property I should apply to choosing an investment. *Caveat emptor*. Investors should be wary of the organizations to which they entrust their money. Although everything is 20/20 in hindsight, the warning signs seemingly screamed to New Era investors that something was not quite right. In short, perhaps we should all take a lesson from General Patton: “Take calculated risks. That is quite different than being rash.”<sup>646</sup> In sum, “[g]etting something for nothing means just that – the scam artist gets your money and you get NOTHING.”<sup>647</sup>

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someone wants to sue you and take your tunic, let him have your cloak as well. If someone forces you to go one mile, go with him two miles. Give to the one who asks you, and do not turn away from the one who wants to borrow from you.

*Matthew* 5:38-42. Additionally, the gospel of Luke provides a similar lesson:

But I tell you who hear me: Love your enemies, do good to those who hate you, bless those who curse you, pray for those who mistreat you. If someone strikes you on one cheek, turn to him the other also. If someone takes your cloak, do not stop him from taking your tunic. Give to everyone who asks you, and if anyone takes what belongs to you, do not demand it back. Do to others as you would have them do to you.

*Luke* 6:27-32.

<sup>643</sup> Beverly Goldberg, *Free Library of Philly Loses \$1.45 Million in Scam*, July-August 1995 (quoting Pat Martin of the Fund for America’s Libraries).

<sup>644</sup> Maxwell, *supra* note 46.

<sup>645</sup> Carnes, *New Era’s Bennett to Prison*, *supra* note 9.

<sup>646</sup> Risk-taking quotes, 2006, <http://thinkexist.com/quotations/risk-taking/2.html> (last visited Apr. 8, 2008) (attributing the aforementioned quote to General Patton).

<sup>647</sup> Spencer, *supra* note 7.