

Ponzi Schemes: A Growing Hazard In Film Financing

By **Jarrood Shaw, Benjamin Sitter and Katelyn Fox** (September 2, 2021)

Ponzi schemes focused on fake investment opportunities are nothing new. Bernie Madoff, Allen Stanford and Tom Petters are now household names. But there has been a particular rise of Ponzi schemes specifically in the film and video content industry that has intensified in the last few years.

As streaming services vie for dominance in the frenzied content wars in an effort to draw in more and more viewers, this trend is likely to accelerate. These streaming services will spend tens of billions of dollars this year alone creating and acquiring video content.[1]

These conditions create a perfect breeding ground for Ponzi schemes, given the amount of money changing hands and the lax due diligence standards investors sometimes accept in exchange for the chance to tap into this hot market.

In the last year alone, the largest film financing Ponzi scheme in U.S. history collapsed, and these schemes spread to overseas markets, like China.

As these schemes collapse — as all Ponzi schemes eventually do — and investors realize their losses, there is often a flurry of civil litigation aimed at recovering those losses. Given that the actual schemers are usually in bankruptcy or in prison by then, these lawsuits often target financial institutions and other deep pockets.

Practitioners in this space should be aware of these trends and of the common characteristics and concerns attending these lawsuits as these schemes continue to evolve and expand to new markets and as victims try out new theories of recovery and litigation tactics.

What Can a Film Financing Ponzi Scheme Look Like?

The world of film financing is opaque, with investments coming in from around the world, often times through funding methods that are nonconventional but which may or may not be legitimate.

The lack of conventional forms of financing creates an opportunity for Ponzi schemers to work in the margins and entice unsuspecting filmmakers, finance companies, actors and other artists to take money in the hope of getting a film off the ground and produced. When the schemes crash, the films grind to a halt or limp to a finish, often failing to meet the lofty objectives of its investors.

In some cases, an actor or producer will approach investors to fund a movie. After investors make their initial pledge, the movie may never premier. Fraudsters sometimes use bank accounts and purportedly secure accounts to appear legitimate.

Sometimes they go so far as to elicit the help of a low-level bank employee to falsify records or vouch for the legitimacy of the investment. Where a low-level employee is involved in the



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scheme, even tangentially, banks and financial institutions will face particularly difficult hurdles extricating themselves from these lawsuits.

Another common tactic is to blame banks for failing to identify the fraudulent activity in their accounts based on the theory that certain red flags should have notified banks that their accounts were being used to perpetuate fraudulent transactions.

Here are some recent examples that illustrate the perils of a film financing Ponzi scheme.

Zachary Horwitz and 1inMM

This scheme was exposed in May 2021. Zachary Horwitz, also known as Zach Avery, defrauded investors of \$690 million through his company 1inMM, which claimed to have relationships with Netflix Inc. and Home Box Office Inc.

Horwitz, an actor who appeared in low-budget horror movies, used his connections to the film industry to leverage the purchase and sale of film distribution rights to Netflix and HBO — or at least, that is what he claimed to do. In reality, Horwitz's promises that the promissory notes he secured from investors were safe because of his relationships with the prominent streaming companies were false.

To perpetuate his scheme, Horwitz forged distribution agreements that he sent to investors to pass himself off as legitimate. Horwitz even produced a falsified annual report that described 1inMM's purported acquisitions and sales in dozens of rights to Netflix and HBO.

In 1inMM's annual report, he advertised the solid relationships that indicate the streaming giants' desire to acquire the rights to any title that 1inMM purchased. During this time, Horwitz paid large multiples to early investors with other investors' money as well as deposited investors' money directly into his bank account, which he used to fuel a lavish lifestyle for himself.

He used some of the money to purchase a \$5.6 million home, cars and other luxuries. In total, he charged upward of \$2.8 million on purchases from his personal bank account, including an interior decorator, high-end automobiles and a luxury watch subscription service.

Once the scheme crashed, Horwitz was arrested and charged with fraud in May 2021. The U.S. Securities and Exchange Commission also sued him and 1inMM for fraud under two sections of the Securities Exchange Act.

A flurry of civil litigation followed. A class action has been filed against Horwitz, his company and the bank he used. The lawsuit alleges that his bank knew of the scheme and assisted it and the victims of the fraud are seeking full recovery of their losses.

Brandon and Kristina Hogan and Paradox Film Group and Fast Jet Distribution

Brandon and Kristina Hogan allegedly together defrauded four individual investors out of approximately \$2.5 million purporting to have a film financing business based on Brandon's experience in the film industry and Kristina's experience as a lawyer for their companies.

Jonathan Helmuth met the Hogans after a screening at the Sundance Film Festival, and Brandon proposed that they work together to develop and finance films. Helmuth introduced the Hogans to his acquaintances, and the financing business received a large influx of

investments. The Hogans represented that their businesses were part owners of or investors in four films around this time.

In the summer of 2020, after investors had been impatiently waiting for returns for months, the Hogan's personal plane crashed while flying to Wyoming, resulting in Brandon's death.

Helmuth traveled to the Hogan's personal home in Montana and began investigating the financials of the business, but learned that the financing companies had not been conducting business financing films but rather had funded the Hogans' extravagant personal lives.

The investors have not received any interest payments or their principal to date, and they together filed a suit against Kristina, Brandon's estate and the financing companies. The filed complaint alleges that the Hogans' businesses were operating, or planning to operate, as a Ponzi scheme given the failure to invest in films as promised.

In addition to fraud, conversion, breach of fiduciary duty and common law causes of action, the investors seek to have transfers from the financing companies to the Hogans deemed fraudulent and recover those funds.

Weathervane Productions, Forrest Capital and Benjamin McConley

Weathervane Productions Inc. and Benjamin McConley, through his entity Forrest Capital Management, jointly approached potential investors regarding over a dozen different film and stage financing projects.

Many of the films starred well-known actors and actresses including Natalie Portman ("Jane Got a Gun"), Mandy Moore ("47 Meters Down"), Ewan McGregor, Natasha Lyonne ("Antibirth"), Chloe Sevigny, Laura Dern, Pierce Brosnan ("Urge") and Ashley Judd ("Trafficked").

Forrest Capital convinced investors to invest over \$60 million in their projects through a matched investment structure, through which McConley would supposedly deposit matching funds into a secure bank account with the investor funds. In reality, the accounts were not secured and McConley used the funds for his own purposes.

McConley pled guilty to federal wire fraud charges and will be sentenced in September 2021. The fallout from his scheme has led to over a dozen civil lawsuits against him, Forrest Capital, Weathervane and various banks with which they banked.

The claims against the banks generally alleged that the banks knew or should have known of the fraud either because of red flags on the accounts or because low-level employees assisted with the fraud.

The plaintiffs, who included actors, directors, producers and film finance companies, often alleged that the films at issue either were not completed at all or were commercial failures because Forrest Capital stole funds that should have been used to finance the production and marketing of the films.

Strategic and Practical Considerations in Film Financing Ponzi Litigation

As the examples above illustrate, film financing Ponzi litigation tends to involve certain recurring themes and issues that any practitioner in this space should be aware of and

factor into their strategic decision making.

Ponzi victims often employ a variety of legal theories and strategies to advance their claims.

Red Flags Theory

Plaintiffs in these cases often employ a red flags theory to support their claims.

Essentially, they argue that defendants should have known that the perpetrators of the particular Ponzi scheme were involved in illegal activity and should have ceased doing business with them or warned the victims of these activities. In support of this theory, plaintiffs counsel will often seek discovery into banks' reporting of suspicious activity to bank regulators.

This tactic can be problematic for bank defendants, as banking regulations expressly prohibit banks from sharing suspicious activity reports, and in fact make it a crime to even confirm or deny the existence of a SAR. In general, however, most courts agree that a bank does not owe a duty to monitor its customers' bank accounts to ensure there is no unlawful activity. Accordingly, this approach often fails.[2]

It also bears noting that many victims of the Ponzi scheme may have entered into the transactions having done little or insufficient due diligence. They may also have ignored red flags or warning signs of their own, such as knowledge of prior defaults by the schemers, prior failed film projects or of other parties that had complained of their failure to repay.

Defendants should explore these issues, as they may undermine the argument that the victims relied on actions by the defendant to their detriment, and may also support defenses based on a failure to mitigate losses.[3]

Direct Involvement

The cases that present the most difficulty and potential exposure for financial institutions are those in which it is alleged that an insider at the bank knew of or assisted in the perpetration of the scheme.

In most cases, the employee's actions will be imputed to the institution. Bank defendants may argue that the employee was acting outside the scope of her employment, but those arguments may not gain much traction if the employee was performing banking duties at the time of their involvement.[4]

Damages Issues

Damages issues are frequently central in these cases. Where the injured party suffered a direct investment loss relating to the scheme, damages may be fairly straightforward. But it is common for parties to also seek recovery of lost profits that they expected from the particular film project in which they invested.

Indeed, some plaintiffs may not have suffered any direct investment loss at all, and may simply seek recovery based on the alleged harm to the film's financial prospects because promised funding failed to materialize due to the scheme.

Of course any film investor expects that the film they invested in would be a financial success, but the nature of film financing is inherently speculative and for every blockbuster

there are hundreds of movies that fail to break even.

Defendants in these cases should consider securing expert testimony regarding the inherently risky and speculative nature of investing in films as a defense to damages claims that include lost profits and/or speculative or consequential damages.

Key Takeaways About Film Financing Ponzi Schemes

Ponzi schemes will likely continue to rise in the quickly expanding market for film financing, especially as demand for new video content — and competition between streaming services — continues to intensify.

Banks and financial institutions should be aware of the prevalence of these schemes and risk of getting caught up in civil litigation after a Ponzi scheme collapses, as victims will target parties with deep pockets.

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[1] See, e.g., "Netflix Reveals \$17 Billion in Content Spending in Fiscal 2021," *Variety*, Apr. 20, 2021.

[2] See, e.g., *Hsi Chang v. JPMorgan Chase Bank, N.A.*, 845 F.3d 1087, 1094 (11th Cir. 2017) ("Florida, like other jurisdictions, recognizes that as a general matter, a bank does not owe a duty of care to a noncustomer with whom the bank has no direct relationship.").

[3] See, e.g., *Foreline Sec. Corp. v. Scott*, 871 So. 2d 906, 910 (Fla. 5th DCA 2004) (to prove fraudulent misrepresentation, a plaintiff must show that the defendant "made a misrepresentation that she personally relied upon.").

[4] See, e.g., *Guardian Angel Credit Union v. MetaBank*, No. 08-CV-261-PB, 2011 WL 2784078, at *6 (D.N.H. July 14, 2011) ("That a bank does not have a general duty to protect non-customers from torts involving its accounts says nothing about its duty to adequately supervise its employees.").