

Ponzi: Blimps & Boy Bands

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Fraudster: *"It just got way blown out of proportion" ...*

'Victim': *"[He] gave us all the ability to have lives today."*

The quotes above could be from any fraudster and their victim. It is highly likely quotes similar to the ones above were used in reference to Bernie Madoff, one of the most well-known and talked about Ponzi fraudsters. So how did Bernie do it all? According to Madoff, it all got too big...too much for him...he never intended it to get to the level it did. As for the victims, when I visited him in prison in North Carolina, Madoff told me "they were only victims when I got caught." Meaning, up until the collapse of his Ponzi scheme, many of the 'victims' made a lot of money.

In the opening quotes, 'The Fraudster' is Lou Pearlman and 'the Victim' is Aaron Carter, one of the USA's most successful recording and performing artists of the early 21st century. They come from a YouTube Original movie, 'The Boy Band Con: The Lou Pearlman Story'. In 2002, at the age of 14, Carter filed a lawsuit accusing Pearlman of cheating him out of hundreds of thousands of dollars and of racketeering in a deliberate pattern of criminal activity.

In 2008, Lou Pearlman was convicted of running one of the largest and longest-running Ponzi schemes in history. The \$300 million in debt he left behind seems like small change after Bernie Madoff, but his story offers fascinating insight into how Ponzi schemes work, how people get caught up in them, how many people make a lot of money during the scheme, and how incredulous many of the victims are once it all collapses.

Pearlman was the creator of 1990's boy bands such as the Backstreet Boys (who would sell some 130 million records worldwide) and 'N Sync (who would sell some 70 million records worldwide). Pearlman's bands were selling millions of records a week. The cash was flowing through his various companies but not, it seems, back out to his boy bands. For 'N Sync, the Waterloo moment came in an LA restaurant in late 1999. 'Surviving' on *per diems* of \$35 per day at the time, after years of hard toil, the hugely successful group was expecting large payouts when they turned up for a band meeting / celebration where they were to be presented with cheques. To quote JC Chasez, a member of the group, they expected "some big, magical cheque" ...but what they received barely reached four figures. "Not to sound ungrateful," said 'N Sync's Lance Bass in the YouTube movie, "but when you compare it to how many hours we put into this group for years, it didn't even touch minimum wage." 'N Sync's most famous graduate, Justin Timberlake, said he felt as though he'd been "financially raped by a Svengali."

The lawsuits began to mount up against the Svengali in the early 2000's. As he fought to keep control of his business empire and the millions to his name, the truth began to emerge about his corporation TransContinental, which he had set up some 20 years prior. He claimed that TransContinental included an airline (he chartered a lot of planes), a film and music studio (he rented a lot of studio time for his musical acts), restaurants, real estate, talent and travel agencies. He had launched an investment scheme dubbed an 'employee investment savings account' in order to lure unwitting investors. He had a folded over business card that listed the 40 or 50 companies he claimed to own. A private jet would pick up investors and bring them to his home city of Orlando and a limo would drive them to the offices. He'd always be busy when the would-be investor arrived, usually (allegedly) on a call with someone suitably famous in the entertainment industry. Investors would be taken to the studio to see the Backstreet Boys recording. They'd be taken to the fanciest restaurants, and ultimately they'd be taken in by the Svengali with the Midas touch.

The Accused: *"Those that believe, no explanation is necessary. Those that don't believe, no explanation will suffice."*

Pearlman's larger-than-life persona helped woo those who did believe. In many frauds and Ponzi's, we later hear that old adage of "if it's too good to be true it usually is." However, this was only true to a certain extent in the Pearlman case. Yes, it was true of the investment returns promised - yes, it was true of the sham lifestyle that investors were impressed by, but the success of the boy bands was real. They really were selling millions of records, - they really were selling out those arenas and stadiums.

Pearlman began making money with blimp advertising in New York before moving on to chartering helicopters for short trips around Manhattan. In college he had written a business plan for a class project based on a helicopter taxi service in New York. Some might say he was a man ahead of his time, as it's now possible to catch an Ubercopter from the airport to central Manhattan relatively easily.

A chequered business career saw him set up that helicopter taxi service with one helicopter, get involved in lengthy legal proceedings which awarded him \$2.5m in damages and aligning himself with other dubious characters who then assisted him with keeping his penny stock liquid before moving his operation to Orlando, Florida.

Around this time, the group New Kids on the Block were the biggest selling pop stars in the US, and Pearlman decided he wanted a bit of that action. His success with the Backstreet Boys would eclipse the fame and sales of New Kids on the Block, but he needed funding to get them off the ground. This is where TransContinental and his ability to self-promote came into play. As funds flowed into his now burgeoning Ponzi scheme, the pop groups took off, as did his lifestyle. The more success he had, the more funding the Ponzi needed in order to sustain everything. It was a classic Ponzi fraudster situation that spiralled into something he couldn't get out of...much like the Madoff story. During my visit to his prison, Madoff told me of a time when he tried to redeem a large portion of investors. He told the forcibly redeemed investors (mainly those closest to him in his community) that he was limiting his direct investor base. While Madoff could not service all investor redemptions (as is the nature of Ponzi schemes), Madoff cited this position to me as evidence that he was trying to lessen the growth of the fraud. However, ironically, he became a victim of his own (perceived) success. As quickly as he was

writing cheques to large individual investors, they were re-investing the money indirectly through many of the Madoff feeder funds, thereby counter-acting the direct redemptions.

When Pearlman's boy bands started looking for what they were owed the 'wheels started to come off' TransContinental, magnified by the funds required for expensive lawyers and lawsuits. In 2006, Florida investigators discovered Pearlman had perpetrated a long-running Ponzi scheme that defrauded investors out of more than \$300m. Bankruptcy proceedings began in early 2007, and in a last desperate flourish of his colourful life, Pearlman appeared on German television, he was spotted in Russia, Brazil and Spain, and ultimately he was found in Bali where he would be identified by two tourists who tipped off the local police.

Extradited back to the US to face charges, in 2008 Pearlman was sentenced to 25 years in prison on charges of conspiracy, money laundering and making false statements during a bankruptcy proceeding. He died in prison in Miami in 2016.

So, while the Pearlman story is not quite the 'too good to be true' red flag as with Madoff and many others, it does serve as a reminder to look behind the glamorous façade. Fraudsters will try to deflect and distract attention while hiding in plain view such as Madoff as NASDAQ chairman and Pearlman as a pop music mogul. Both very successful in their own right in legitimate business, showing that there may often be real success and lucrative business enterprises running alongside the fraud. Couldn't Pearlman have lived a lavish (and legal) lifestyle on his boy band earnings, thus staying out of jail and living out his life of fancy restaurants and showbiz parties through to retirement? Couldn't Madoff have lived a lavish (and legal) lifestyle on the earnings of the legitimate side to his business empire, thus staying out of jail and retiring to sail and fish the Florida Keys? Perhaps.

The first stream of income that comes from the initial fraud can spawn legitimate and sometimes successful side enterprises. However, the success of these side-ventures (perceived or real), usually in glamorous or high-risk investment sectors such as music production, adds tangibly to the mystic, prestige, and Midas persona of the fraudster. Even in instances where the 'legitimate' pre, post or side-venture is successful, and the net proceeds may be used to fund the redemption of Ponzi victims (and gradual exit of the fraud), the greedy, egotistical and often self-delusional nature of the fraudster is set... so the lure of the extra dollar is too much to resist.

Is there a lesson to be learned here? Certainly, while there may be material and undeniable success in the history of the person fishing in your pockets for his next investment dollar, at what real and hidden price did that success come? So, be as wary and as sceptical of the seemingly successful investor as with the one you know very little about.

'The Boy Band Con: The Lou Pearlman Story' – is a Youtube Originals movie and available to watch on Youtube.

BDO invites enquires regarding resources and other ways our firm can provide assistance with such matters to Declan Magennis (DMagennis@bdo.ky) or Russell Smith (RSmith@bdo.ky).