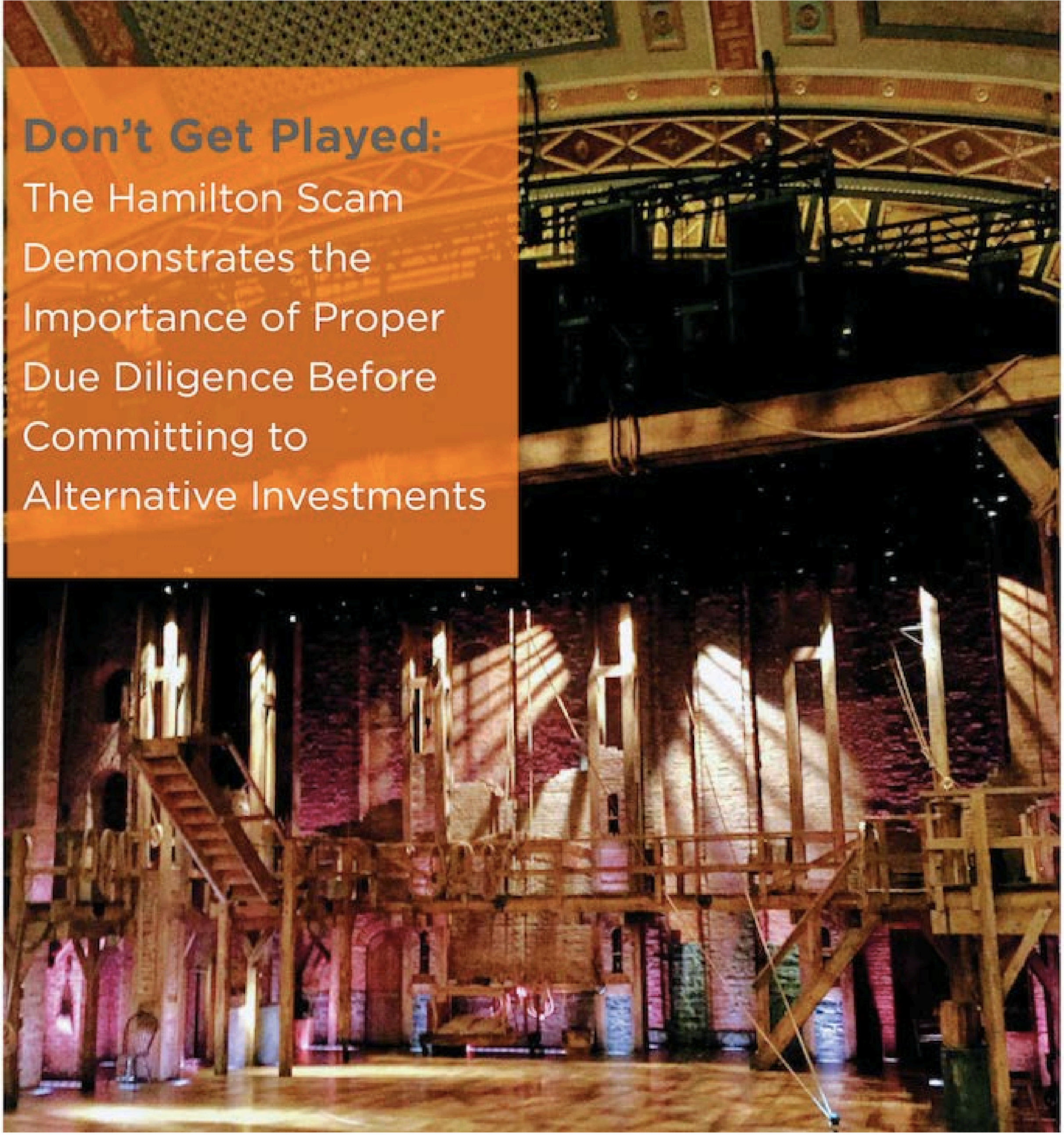
Don't Get Played:
The Hamilton Scam Demonstrates the Importance of Proper Due Diligence Before Committing to Alternative Investments



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Investors in securities, either through registered broker-dealers or investment advisors, generally have plenty of resources on the internet to conduct adequate due diligence, reassuring themselves that those involved in handling their investments do not present fraud risk.

Investors contemplating putting money into an alternative investment, however, do not have such resources readily available. And yet, in this latter scenario, the need for vigorous due diligence to be reasonably informed in weighing the considerable risks of the proposed "exotic" investment is heightened. A prudent investor needs to conduct due diligence into the investment fund itself and those who principally own the fund, its managers, and any other related parties. Failure to do so could result in catastrophic losses, as investors in the Hamilton scheme learned.

From 2015 to January 2017, Joseph Meli and Matthew Harriton, unregistered investment professionals, capitalized on the rapidly growing secondary ticketing market raising funds from multiple notable investors. The investment was sold as a surefire way to make a quick buck: Meli and Harriton allegedly promised to use inside connections with producers to buy blocks of tickets to high-profile entertainment events, such as the Broadway hit musical Hamilton, and then to resell the marked-up tickets for substantial profit. The scheme was disguised by informal credibility—Meli was a former New York City concert promoter with connections to the entertainment industry. Investors were promised a return of their investment within nine months, along with an additional 10-percent annualized return. Investors were further eligible to receive a 50-percent share of any leftover profits at the end of the enterprise. The deal was presented as low risk because the show tickets were in demand and had an intrinsic face value. Meli and Harriton raised approximately $97 million from at least 138 different investors, including billionaires.

Meli and Harriton's Ponzi scheme was revealed when the Securities and Exchange Commission filed a civil complaint on January 27, 2017. The SEC alleged that more than half of the investment funds, nearly $60 million, were used to make payments to prior investors, while other funds were diverted directly to Meli and Harriton. None of the purported income was from any business activity. The SEC estimated that only "a small fraction" of investor funds went to pay third-party entities with "any apparent connection to ticket sales or live event production." Meli and Harriton allegedly expended some of the investment funds on personal expenses, such as jewelry purchases, private school tuition, and payments to casinos. Meli and Harriton allegedly expended some of the investment funds on personal expenses, such as jewelry purchases, private school tuition, and payments to casinos. The SEC complaint was expanded on March 7, 2017, adding five relief defendants, including family members and close colleagues of Meli and Harriton. In a parallel case, Meli and one other individual, Steven Simmons, were arrested and charged by the US Department of Justice.

Had potential investors looked past the veneer of legitimacy, created by peer relationships, and done thorough due diligence into the principals behind the Hamilton investment funds, they would have discovered that Harriton's name surfaced in high-profile stock-manipulation investigations from the late 1990s. Those investigations performed by the SEC, as well as federal and state prosecutors, brought to light Harriton's connection with notorious fraudster Randolph Pace. Despite being barred from the securities industry in 1988 for his role in an earlier securities fraud, Pace masterminded a conspiracy in the 1990s to manipulate penny stocks to the tune of a reported $200 million in illegal profits. The investigations allegedly focused on Harriton's role as an investor or officer in three of the manipulated companies. Though Harriton was not ultimately arrested or charged, his connection to this well-known fraudster and association with multiple companies subject to stock manipulation is certainly material information that any diligent investor would want to consider before entrusting him with hard-earned cash.

So how can individual investors best equip themselves with sufficient knowledge before making important investment decisions? Fortunately, several freely available internet resources are at their fingertips, which, though not comprehensive, are a great place to start. The SEC and Financial Industry Regulatory Authority websites have tools to search a registered broker's or investment advisor's background. Even a well-designed Google search can uncover regulatory actions and adverse media in major publications. However, an investor committing significant capital to the most sophisticated investment schemes would be wise to seek the assistance of an outside provider with due diligence and investigative expertise. The investigations industry has technology that can use algorithms to scour the internet for all permutations of an investment principal's name, unearthing actionable intelligence from proprietary data sources and the darkest corners of the web. Where questions remain, the investor might find it appropriate to obtain a discreet human source inquiry to dive even deeper.

For their part, securities brokers and investment advisors steering clients to alternative investments would be wise to retain the services of a due diligence and investigative firm. This is not only in the best interests of the client, as noted above, but could mitigate liability for the advisor should the investment sour and the investor look to pass the buck for any losses. For example, on February 6, 2017, one of the investors defrauded in the Hamilton scheme sued his broker-dealer for, among other things, failing to conduct adequate due diligence.

As the Hamilton Ponzi scheme makes plain, those contemplating alternative investments need to undertake sophisticated due diligence into the investment fund and all relevant professionals associated with the investment. Proper due diligence allows investors, brokers, and advisors to make reasonably informed decisions based on an evaluation of the known risks. Robust due diligence is essential for investors to avoid getting “played” by fraudsters.

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