Nos. A12-1930 and A12-2092

State of Minnesota
In Supreme Court

Patrick Finn and Lighthouse Management Group, Inc.,

Appellants/Cross-Respondents,

v.

Alliance Bank,

Respondent,

Home Federal Bank,

Respondent / Cross-Appellant,

KleinBank,

Respondent/Cross-Appellant,

Merchants Bank N.A.,

Respondent/Cross-Appellant,

M&I Marshall & Ilsley Bank,

Respondent/Cross-Appellant,

American Bank of St. Paul, et al.,

Defendants.

APPELLANTS PATRICK FINN AND LIGHTHOUSE MANAGEMENT GROUP, INC.'S BRIEF AND ADDENDUM

Larry B. Ricke (#121800)
Karl E. Robinson (#0274045)
SWEENEY & MASTERSON, P.A.
Suite 600, Degree of Honor Building
325 Cedar Street
St. Paul, MN 55101
(651) 223-8000

William M. Hart (#150526)
MEAGHER & GEER, P.L.L.P.
33 South Sixth Street, Suite 4400
Minneapolis, MN 55402
(612) 338-0661

Attorneys for Patrick Finn and Lighthouse Management Group, Inc.

(Additional Counsel in this matter listed on following page)

2013 – BACHMAN LEGAL PRINTING – FAX (612) 337-8053 – PHONE (612) 339-9518 or 1-800-715-3582

Christopher R. Morris (#230613)
BASSFORD REMELE, P.A.
33 South Sixth Street
Suite 3800
Minneapolis, MN 55402
(612) 333-3000

Attorneys for Alliance Bank

Kevin M. Decker (#0314341)
Benjamin E. Gurstelle (#0389968)
BRIGGS AND MORGAN, P.A.
2200 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
(612) 977-8400

Attorneys for Home Federal Bank

Shari L.J. Aberle (#0306551)
Erin Collins (#0388967)
DORSEY & WHITNEY LLP
50 South Sixth Street, Suite 1500
Minneapolis, MN 55402-1498
(612) 340-2600

Attorneys for KleinBank

Mark A. Merchlewitz (#0143832)
BENSON & MERCHLEWITZ
174 Main Street
Winona, MN 55987
(507) 454-3752

Attorneys for Merchants Bank

Keith S. Moheban (#216380)
Peter J. Schwingler (#388909)
Katherine E. Devlaminck (#391961)
LEONARD, STREET AND DEINARD
Professional Association
150 South Fifth Street, Suite 2300
Minneapolis, MN 55402
(612) 335-1500

Attorneys for M&I Marshall & Ilsley Bank

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STATEMENT OF LEGAL ISSUES

1. **Does Minnesota follow the Ponzi-scheme presumption—a rule followed elsewhere by overwhelming consensus—in fraudulent transfer actions brought under the MUFTA to establish the debtor's fraudulent intent, insolvency and the failure to provide reasonably equivalent value for the transfer of profits?**

The district court ordered summary judgment for the Receiver and against Alliance, ruling the undisputed facts established that First United and Johnston "were engaged in a Ponzi scheme," that Alliance "directly benefited from the scheme" and that "the Ponzi-scheme presumption applies" to establish that First United's transfers of profits to Alliance were fraudulent. (Add 33-50) The court of appeals reversed, ruling it was proper to apply the Ponzi-scheme presumption to establish First United's fraudulent intent and insolvency, but that it could not apply the presumption to establish Alliance's failure to provide reasonably equivalent value for the profits it received from First United. (Add17-31)

This issue was raised in the trial court and preserved for appeal in the arguments made in the Receiver's and Alliance's cross-motions for summary judgment and in Respondent Banks' motion to dismiss.

Most Apposite Authority:

Donell v. Kowell, 533 F.3d 762 (9th Cir. 2008)
Scholes v. Lehmann, 56 F.3d 750 (7th Cir. 1995)
In re Polaroid Corp., 472 B.R. 22 (Bankr. D. Minn. 2012)
Finn v. Peoples Bank of Wisc., 2012 U.S. Dist. LEXIS 130863 (W.D.Wis. Aug. 22, 2012)
Minn. Stat. §§ 513.41-.51

2. **Did the court of appeals err in reversing the district court's order for summary judgment in the Receiver's favor, and in ruling that Alliance Bank provided "reasonably equivalent value" for its Ponzi-scheme profits:**

   (a) Because the court of appeals wrongly refused to apply the Ponzi-scheme presumption to establish that Alliance did not provide reasonably equivalent value for its profits; or

   (b) Because the court of appeals' ruling misapplied the facts, wrongly made findings of fact, wrongly disregarded the district court's findings of undisputed fact, or otherwise misapplied the standard of review on appeal from summary judgment?

The district court granted summary judgment for the Receiver and against Alliance, finding the undisputed facts established that First United was "engaged in a Ponzi scheme," that Alliance received $1,235,308 in profits from First United, that Alliance "directly benefited from the scheme," and that "the Ponzi-scheme presumption applies" to establish that Alliance failed to provide reasonably equivalent value for the profits it received. (Add 33-50) The court of appeals reversed and directed entry of judgment in favor of Alliance, concluding the "uncontested" facts established that Alliance provided reasonably equivalent value for the profits it received. (Add29-31)

This issue was raised in the trial court and preserved for appeal in the arguments made in the Receiver's and Alliance's cross-motions for summary judgment.

Most Apposite Authority:

Donell v. Kowell, 533 F.3d 762 (9th Cir. 2008)
Scholes v. Lehmann, 56 F.3d 750 (7th Cir. 1995)
In re Polaroid Corp., 472 B.R. 22 (Bankr. D. Minn. 2012)
Finn v. Peoples Bank of Wisc., 2012 U.S. Dist. LEXIS 130863 (W.D.Wis. Aug. 22, 2012)
Minn. Stat. §§ 513.41-.51

3. Which statute of limitations applies to the Receiver's fraudulent transfer claims under the MUFTA?

The district court dismissed the Receiver's actual and constructive fraudulent transfer claims under the MUFTA against Respondent Banks as barred by the statute of limitations for "liability created by statute" in Minn. Stat. § 541.05, subd. 1(2). (Add51-71) The court of appeals reversed in part and affirmed in part, holding actual-fraud claims are governed by the statute of limitations for actions "for relief on the ground of fraud" in Minn. Stat. § 541.05, subd. 1(6), but constructive-fraud claims are governed by the statute of limitations for "liability created by statute" in Minn. Stat. § 541.05, subd. 1(2). (Add7-16) The court ruled the Receiver's constructive-fraud claims accrued before discovery of the Ponzi scheme and were time barred, but the Receiver's actual-fraud claims were timely if brought within six years of the discovery of the Ponzi scheme. (Add31-32)

This issue was raised in the trial court and preserved for appeal in the arguments made in Respondent Banks' motion to dismiss and the Receiver's response to the motion.

Most Apposite Authority:

McDaniel v. United Hardware Dist. Co., 469 N.W.2d 84 (Minn. 1991)
In re Petters Co., Inc., 494 B.R. 413 (Bankr. D. Minn. 2013)
Underleak v. Scott, 134 N.W. 731 (Minn. 1912)

Lind v. O. N. Johnson, Co., 282 N.W. 661 (Minn. 1938)
Minn. Stat. § 541.05, subd. 1(6)
Minn. Stat. § 541.05, subd. 1(2)

STATEMENT OF THE CASE

A. Overview

Corey Johnston operated First United Funding, LLC, as a Ponzi scheme from 2002 through 2009. (A134) In 2010, the United States Attorney charged Johnston with crimes relating to his operation of the $80 million First United Ponzi scheme that involved defrauding banks through the sale of loan participations. (A42-49) Johnston pleaded guilty and is in federal prison. (A1)

The Dakota County District Court appointed Patrick Finn and Lighthouse Management Group, Inc. as Receiver for First United. (Add35) They commenced these consolidated actions under the Minnesota Uniform Fraudulent Transfer Act ("MUFTA"), Minn. Stat. §§ 513.41-.51, against Alliance Bank ("Alliance"), and against Home Federal Bank, KleinBank, Merchant's Bank and M&I Marshall & Ilsley Bank (collectively, "Respondent Banks"). (A1-132) MUFTA provides that a debtor's transfer made with actual or constructive "intent to hinder, delay, or defraud any creditor" is avoidable, unless the recipient took the transfer in "good faith" and for "reasonably equivalent value." Minn. Stat. §§ 513.44(a)(1) & 513.48(a). MUFTA does not contain a statute of limitations.

The Receiver seeks to recover the bank's "profits"–the amounts First United transferred to the bank in excess of the amounts the banks transferred to First United.

(A1-132) These profits will be distributed to the Ponzi-scheme victims who have suffered more than $90 million of principal losses. (A409)

B. The Receiver's Fraudulent Transfer Claims Against Alliance

The Receiver's fraudulent transfer claims against Alliance seek recovery of Alliance's profits. (A1-132) Alliance and the Receiver brought cross-motions for summary judgment. The district court denied Alliance's motion, granted the Receiver's, and directed entry of judgment for $1,235,308, the profits Alliance received from First United's Ponzi scheme. (Add33-50) In doing so, the district court recognized and applied the Ponzi-scheme presumption. (Add39-45) The Ponzi-scheme presumption recognizes that "[w]here causes of action are brought under [the Uniform Fraudulent Transfer Act] against Ponzi scheme investors, the general rule is that to the extent innocent investors have received payments in excess of the amounts of principal that they originally invested, those payments are avoidable as fraudulent transfers." (Add40)

Alliance appealed. The court of appeals reversed, ruling that Alliance, rather than the Receiver, was entitled to summary judgment. (Add1-32) The court held that the undisputed facts established First United was engaged in a Ponzi scheme (A20), and that the district court had correctly applied the Ponzi-scheme presumption to establish that First United had actual intent to defraud and was insolvent when it made transfers to Alliance. (A21-26) However, the court also held that, as an intermediate error-correcting court, it could not apply the Ponzi-scheme presumption to establish Alliance did not provide reasonably equivalent value for its profits, stating only this court or the legislature could do so. (A29) The court further ruled that Alliance had provided reasonably equivalent value for its Ponzi scheme profits. (A28-31)

C. The Receiver's Fraudulent Transfer Claims Against Respondent Banks

The Receiver's fraudulent transfer claims against Respondent Banks seek recovery of more than $900,000 in aggregate profits these banks received from First United's Ponzi scheme. (A1-132) The Respondent Banks moved to dismiss the Receiver's Complaint under Minn. R. Civ. P. 12, arguing the claims are barred by the statute of limitations. (Add51-69)

The district court held the Receiver's MUFTA claims are governed by Minn. Stat. § 541.05, subd. 1(2), which provides the limitations period for "liability created by statute" and which has no discovery rule. (Add59-63) The court rejected the Receiver's argument that MUFTA actual and constructive fraudulent transfer claims are actions "for relief on the ground of fraud" so that Minn. Stat. § 541.05, subd 1(6)—which does contain a discovery rule—applies to the Receiver's claims. (Add59-63) The court also ruled that the Receiver's claims against Respondent Banks are time-barred because First United made the transfers to Respondent Banks more than six years before the Receiver commenced the action, even though the fraud was not discovered until the Ponzi scheme unraveled years later. (Add59-63)

The Receiver appealed. The court of appeals reversed in part and affirmed in part. First, the court held that MUFTA actual-fraud claims are actions "for relief on the ground of fraud" and, therefore, Minn. Stat. § 541.05, subd. 1(6) applied. (Add14-15) Because the Ponzi scheme was not discovered until the Receiver was appointed in 2009, the

Receiver's MUFTA actual-fraud claims are timely. (Add14-16, 31-32) Second, the court held that MUFTA constructive-fraud claims are not actions "for relief on the ground of fraud," but instead are claims for "liability created by statute" under Minn. Stat. § 541.05, subd. 1(2). (Add7-16) Accordingly, the court ruled that the Receiver's constructive-fraud claims are time barred because First United made the transfers to Respondent banks more than six years before the Receiver commenced its action. (Add7-16, 31-32)

STATEMENT OF FACTS

A. Overview of the First United Ponzi Scheme

Johnston ran First United as a Ponzi scheme from 2002 to 2009. (A134) First United's ostensible business involved facilitating participation interests or assignments in loans made by First United. (A133-148) First United loaned or purported to loan funds to borrowers in exchange for promissory notes and other assurances of payment. (A133-148) The promissory notes and related loan documents were between the borrower and First United. (A133-148) First United then entered into participation agreements or assignments with various banks (the "Participants"), whereby one or more Participants purportedly purchased an interest in a promissory note. (A133-148) Loan participations are not loans; they are investments in a loan made by another party:

> [A]n institution, acting as a co-lender or which otherwise acquired contractual privity with the borrower lends money to a borrower pursuant to a loan agreement. After the loan agreement is executed and the documentation is otherwise complete, the lead lender then sells all or part of the loan to one or more purchasers. These purchasers are typically called participants. ... Only the lead lender or its assignee maintains a direct

> contractual privity with the borrower. The participant's relationship is solely with the lead lender.

W. Crews Lott, et al., *Structuring Multiple Lender Transactions*, 112 Banking L.J. 734, 735-36 (1995).

In reality, Johnston operated First United as a massive Ponzi scheme expressly designed to defraud the Participants and enrich Johnston. *Comm. First Bank v. First United Funding, LLC*, 822 N.W.2d 306, 311 (Minn. App. 2012). As the district court noted, "[h]owever the parties may characterize First United's business model ... it was a Ponzi scheme. No genuine issue of material fact exists regarding that conclusion." (Add152) Alliance and Respondent Banks "do not dispute the district court's determination that First United was engaged in a Ponzi Scheme." (Add20)

Johnston conducted the Ponzi scheme by selling participations in loans that did not exist, by selling participation interests that exceeded the actual loan amounts, and by engaging in other fraudulent conduct, such as making payments to Participants when the borrower had not made a payment. (A5-9) To perpetrate these fraudulent transactions, First United presented false documents and information to the Participants, forged borrower signatures, cut and pasted or otherwise appended borrower's signatures to loan documents that were false, and altered brokerage account statements and other financial documents. (A9) Johnston used the funds realized from the Ponzi scheme to perpetuate the scheme and to support his lavish lifestyle, which included siphoning over $23 million for himself and his family. (A5-11)

The Ponzi scheme started by at least August 2002 and continued until the Receiver was appointed in 2009. (A5-12; A134) By 2002, "First United was insolvent, and the magnitude of its insolvency increased every day that it was in operation." (Add3)

The funds transferred between First United and the Participants were commingled Ponzi-scheme funds that flowed through First United's common bank accounts. (A9-11) Between 2002 and 2009, First United made more than 12,000 transfers, totaling over $1.6 billion. (A9-10)

Central to the Ponzi scheme's implementation and perpetuation was the commingling of Participant funds and borrower payments in First United's common accounts. (A10) This allowed Johnston to keep the Ponzi scheme afloat. (A10) For example, when a Participant transferred funds to First United that First United had represented (or misrepresented) it would transfer to a borrower, Johnston would "replenish" the common bank account by commingling those funds with whatever funds were on deposit. (A10, 133-148) Similarly, when borrowers made payments to First United, Johnston would deposit the funds in the commingled account. (A10, 133-148) Johnston would use these commingled funds to perpetuate the scheme, sometimes stealing money, or sometimes transferring money to a Participant. (A10, 133-148)

All of this commingling allowed Johnston to withdraw over $23 million for his own personal uses, as well as make payments to Participants even when no underlying loan existed, when the participations sold in a loan exceeded 100%, or when a borrower failed to make a payment. (A10, 133-148) When no underlying loan existed – and First United therefore received no incoming loan payments to pay Participants – Johnston used commingled funds to pay Participants in the fictitious loans. (A10, 133-148) When Johnston had sold more than 100% participation interests – and First United therefore received insufficient incoming loan payments – Johnston used commingled funds to pay oversold participation interests. (A10, 133-148) When a borrower failed to make a payment, Johnson used commingled funds to pay the Participant. (A10, 133-148)

Among the "other sources" of funds was Participant funding and borrower re-payments on loans that were not fictitious and for which the corresponding participations were not oversold. Johnston defrauded Participants in those loans by presenting First United as a solvent, legitimate enterprise. Because First United was, and remained, insolvent beginning and after 2002, the security of these Participants' participations was at all times dependent upon Johnston's ability to avoid detection. (Add37) ("The true security Alliance depended on . . . was First United's ability to switch money away from other unwitting lenders to pay Alliance."). Johnston commingled the incoming funding and loan re-payments for these loans and used the commingled funds indiscriminately to pay the random next-in-line Participants, thus maintaining the appearance of solvency, avoiding detection, and keeping the Ponzi scheme afloat. (A397) (First United "designed and executed a classic Ponzi scheme"). All of the loan participations played a part in perpetuating Johnston's Ponzi-scheme model. (A397) (First United's "activities were performed with an eye towards perfecting an extensive fraud"). As the district court observed, "First United engaged in fraudulent transfers of money that were commingled to the point that it is impossible to unravel legitimate transactions from illegitimate ones." (Add36)

On August 6, 2010, federal prosecutors charged Johnston "with operating an $80 million Ponzi scheme with bank money." (A1, 42-51) In September 2010, Johnston pleaded guilty to bank fraud and filing a false tax return. (A1, 53-98) As the factual basis for his guilty plea, Johnston admitted using First United to engage in a scheme to defraud Participants from "sometime in approximately 2005 and continuing to at least March 2009." (A53) Johnston admitted overselling loan participations and fraudulently obtaining more than $79 million from lenders. (A55) Johnston used "some of the proceeds [from excess participations] to repay other loans and perpetuate the scheme, "while diverting" other proceeds of the fraud to his personal use and his family's use." (A55) Johnston admitted he used First United to fraudulently obtain millions of dollars from the Participants and that he used that money to continue the Ponzi scheme and maintain his lavish lifestyle—a classic Ponzi scheme. (A55) Johnston is now in federal prison. (A55)

When the Receiver commenced suit in May 2010, the victims—Participants left holding unpaid participation interests in real, oversold and fictitious loans—had claims for lost principal exceeding $90 million. (A2-3) Alliance and Respondent Banks, however, are not among the victims. First United transferred to each of them their full principal paid plus "profits"—the amounts over and above the banks' payments to First United—before the scheme collapsed. (A1-132) The Receiver seeks to recover these profits from Alliance and Respondent Banks because they were fraudulent transfers. (A1-132) The recovered profits will go towards compensating the victims of the scheme. 822 N.W.2d at 309-13.

B. The Appointment of the Receiver

In October 2009, after two Participants sued First United, the district court appointed the Receiver to manage, control, administer, and take assignment of all First United's assets. (A150-166) At the court's direction, the Receiver undertook an investigation and independent financial analysis of First United's business. (A134)

C. The Receiver's Investigation of the First United Ponzi Scheme

The Receiver's investigation confirmed that First United sold participations that exceeded loan amounts, sold purported participations in counterfeit or nonexistent loans, and engaged in other fraudulent activities. (A2,133-148) First United used the funds fraudulently obtained from Participants to repay earlier Participants and to fund Johnston's lavish lifestyle. (*Id.*) The Receiver's investigation also confirmed that Johnston operated First United as a Ponzi scheme from its inception. (*Id.*)

Specifically, the Receiver's investigation revealed that the First United Ponzi scheme began earlier than Johnston's guilty plea required him to admit and, in fact, began by at least August 2002. (*Id.*) Thus, the Ponzi scheme was operating when Alliance and Respondent Banks engaged in their transactions with First United. The earliest example the Receiver has confirmed occurred on August 1, 2002, when First United obtained $1.5 million each from SY Funding and Dakota Funding, for a total of $3 million. (A135) First United represented that SY Funding and Dakota Funding purchased participation interests in a loan to Interstate Equipment Finance. (*Id.*) However, this loan did not exist. (*Id.*) Instead, First United used the $3 million to make payments to other Participants and for other purposes. (*Id.*) Without the $3 million obtained from SY

Funding and Dakota Funding, First United would not have had sufficient funds to make these transfers. (*Id.*) Even though the loan to Interstate Equipment Finance did not exist and, therefore, no borrower made payments to First United, First United made transfers of purported interest to SY Funding and Dakota Funding. (*Id.*) The funds used to make these payments came from commingled funds, including monies stolen from other Participants. (*Id.*)

Another example from 2002 occurred on October 2, 2002, when Frandsen Bank and Trust transferred $1 million to First United, purportedly for a participation interest in a loan to Interstate Equipment Leasing. (A135-136) However, no such loan existed. (*Id.*) Even though First United made no such loan and, therefore, received no payments from any borrower, First United transferred $1,122,737 to Frandsen Bank and Trust. (*Id.*) The funds used to make these payments came from commingled funds, including monies stolen from other Participants. (*Id.*)

Two more examples highlight the continuation of the Ponzi scheme into 2003 and beyond. On January 7, 2003, First United transferred Charter Bank from one participation interest to another, moving Charter Bank from its $3.41 million participation interest in two loans to Steven Ellman to a participation interest in a purported loan to Jerry and Vickie Moyes of like amount dated October 22, 2002. (A136) There was, however, no loan to Jerry and Vickie Moyes dated October 22, 2002; the loan documents First United provided to Charter Bank were counterfeit. (*Id.*) Nonetheless, First United paid Charter Bank $1,269,452 over the next four years, even though there was no underlying borrower. (*Id.*) First United used commingled funds for those payments, including monies stolen from other Participants. (*Id.*)

On January 30, 2003, First United received $500,000 from Decorah Bank and Trust and $500,000 from Stutsman County State Bank. (A136) The two banks each purportedly purchased a 10% participation in a $5 million loan to Jerry and Vickie Moyes. (*Id.*) However, there was no such loan. (*Id.*) Instead, First United used their funds for other purposes. (*Id.*) Notwithstanding this fact, First United made transfers to Decorah Bank of $538,615 and to Stutsman County State Bank of $630,958. (*Id.*) The funds used to make these payments came from commingled funds, including monies stolen from other Participants. (*Id.*)

The transactions detailed above are just a few examples of First United's classic Ponzi-scheme activities—it received funds from a Participant for a purported legitimate business purpose, but the money was not used for that purpose; instead, some was stolen and the rest was used to make payments to earlier investors through common bank accounts with commingled funds. (A136-137) Indeed, the Receiver's investigation established that Johnston employed numerous devises to conduct the Ponzi scheme, including:

- "Counterfeit loans" – participations sold in loans that did not actually exist;
- "Oversold loans" - participations sold in amounts that exceeded the amounts First United loaned to the borrowers;
- "Underfunded loans" – participations where the promissory note amounts exceeded the amount First United funded to the borrower;
- "Fraudulent notes" – participations for promissory notes that were materially different than the promissory note actually signed by the borrowers;

(A133-366)

Ponzi schemes are by definition insolvent from their inception – that is, they immediately generate more liabilities than assets. *Cmty. First* Bank, 822 N.W.2d at 309, n.1. First United was no exception. First United was insolvent from 2002 through 2009. (A137-138, 230-234) The undisputed cumulative shortfall grew each year from 2002 through 2009, ending in a $53.8 million shortfall in 2009. (A138) Neither Alliance nor Respondent Banks submitted any evidence to dispute First United's insolvency or its Ponzi-scheme activities.

D. Alliance and Respondent Banks' Transfers with First United were in Furtherance of the Ponzi Scheme.

Alliance and the Respondent Banks participated in the First United Ponzi scheme by transferring funds to First United for the purported purpose of participating in loans First United made to borrowers. As detailed above, all participations furthered the Ponzi scheme, including Alliance and Respondent Banks' participations. Alliance and Respondent Banks each profited from their participations in the Ponzi scheme because each received more back from First United than they transferred to First United.

1. Alliance's Participation and Profits

Alliance entered into a participation agreement with First United in October 2002 under which Alliance transferred $3,165,735 to First United to purportedly participate in a loan from First United to Jerry Moyes ("Borrower"). (A138, 239-265) Alliance and First United subsequently renewed the participation several times.(A266-356) First United transferred a total of $4,401,123 to Alliance. (A139, 358-365) Thus, Alliance received a profit of $1,235,388 ($4,401,123-$3,165,735=$1,235,388) from First United. (*Id.*)

The Receiver's Cash Transaction Detail, the undisputed summary of First United's financial transactions, shows Alliance's participation was in furtherance of the Ponzi scheme. (A139) Under the participation agreement, Alliance was entitled only to funds First United collected from the Borrower. (A251-253) However, First United often made transfers to Alliance without receiving payment from the Borrower and it also made transfers to Alliance in amounts greater than the amount paid to First United by the Borrower. (A139) For example, on November 28, 2006, the Borrower made a $302,100 payment to First United. (A139) Two days later, on November 30, 2006, First United transferred $453,150 to Alliance. (A139) The $150,000 excess came from the commingled funds in First United's accounts, which included monies stolen from other Participants. (Add36)

Between May 11, 2005 and March 30, 2007, First United made 16 transfers to Alliance of amounts *greater* than what the Borrower paid to First United. (A139) Between January 7, 2003 and April 30, 2007, First United made 23 separate transfers to Alliance without receiving *any* prior payment from the Borrower. (A139) Thus, the Receiver has identified at least 39 transfers from First United to Alliance where the funds undisputedly came from First United's commingled accounts, including monies stolen from other Participants. (*Id.*) These transfers furthered the First United Ponzi scheme. (*Id.*)

The record shows many other discrepancies. (A139-140) The amount First United transferred to Alliance varied from month to month; the dates First United paid Alliance varied from month to month; and First United made no payment to Alliance in some months. (*Id.*) First United made no monthly payment to Alliance in March 2003; May 2004; December 2004; April 2006 and September 2006. (A139-140; A357-365)

Alliance exited the Ponzi scheme with its profits when First United transferred $2.57 million to it on May 31, 2007. (A139) However, Alliance would have been a net loser if the Ponzi scheme had collapsed during that month. (A 139) On May 9, 2007, the Borrower paid First United $2,567,850. (*Id.*) But First United did not make any transfer to Alliance until more than three weeks later, on May 31, 2007. (*Id.*) During that three-week period, First United stole $16 million from Participants who were sold fraudulent participations. (*Id.*) First United commingled these ill-gotten funds with the $2.57 million it had received from the Borrower. (*Id.*) First United used the commingled funds to make transfers of at least $6.7 million to other Participants. (*Id.*) Therefore, if First United had not received the $16 million influx from fraudulently oversold and counterfeit participations, then First United would not have had sufficient funds to make the $2.57 million transfer to Alliance on May 31, 2007. (*Id.*) Accordingly, the May 31, 2007 transfer to Alliance depended on First United's ability to perpetuate the Ponzi scheme. (*Id.*) In other words, but for the continuing fraud in May 2007, Alliance would have never received back the money it paid to First United, let alone its profits. (*Id.*)

2. The Respondent Banks' Participation and Profits

The Respondent Banks also participated in and profited from the First United Ponzi scheme.

a. Home Federal Bank

Home Federal Bank and First United entered into a participation agreement that began on April 24, 2002, and continued through February 20, 2003. (A27-28) Home Federal transferred $3.5 million to First United and received transfers of at least $3,716,712, in furtherance of the Ponzi scheme. (*Id.*) Home Federal realized a profit of at least $216,712 from the Ponzi scheme. (*Id.*)

b. KleinBank

KleinBank and First United entered into a participation agreement that began on March 28, 2002, and continued through November 27, 2002. (A28-29) KleinBank transferred $1,530,000 to First United and received transfers of at least $1,608,742, in furtherance of the Ponzi scheme. (*Id.*) KleinBank realized a profit of at least $78,742 from the Ponzi scheme. (*Id.*)

c. Merchant's Bank

Merchant's Bank and First United entered into a participation agreement that began on February 17, 2004, and continued through March 22, 2005 (A29-30) Merchant's Bank transferred $5 million to First United and received transfers of at least $5,377,569, in furtherance of the Ponzi scheme. (*Id.*) Merchant's Bank realized a profit of at least $337,569 from the Ponzi scheme. (*Id.*)

d. M&I Marshall & Ilsley Bank

M&I Marshall & Ilsley Bank ("M&I") and First United entered into a participation agreement that began on March 27, 2002, and continued through March 18, 2003. (A 30-32) M&I transferred $3.2 million to First United and received transfers of at least $3,472,909, in furtherance of the Ponzi scheme. (*Id.*) M&I realized a profit of at least $272,909 from the Ponzi scheme. (*Id.*)

SUMMARY OF ARGUMENT

The court of appeals erred in refusing to apply the Ponzi-scheme presumption to determine whether First United received reasonably equivalent value in exchange for the "profits" it paid to Alliance in furtherance of the Ponzi scheme. Under the Ponzi-scheme presumption, "to the extent innocent investors have received payments in excess of the amounts of the principal that they originally invested, those payments are avoidable as fraudulent transfers" under the Uniform Fraudulent Transfer Act (the MUFTA in Minnesota). *Donell v. Kowell*, 533 F.3d 762, 770 (9th Cir. 2008). The vast majority of courts have applied the Ponzi-scheme presumption to fraudulent transfer claims under state fraudulent transfer statutes containing language identical to the MUFTA, including multiple courts analyzing the First United Ponzi scheme. *See e.g., Finn v. Peoples Bank of Wisc.*, 2012 U.S. Dist. LEXIS 130863 (W.D. Wis. Aug. 22, 2012). As the Minnesota bankruptcy court explained in applying MUFTA to the Petters Ponzi scheme, the presumption applies because its "logic is unassailable; given the very ethos of a Ponzi scheme," the scheme's operator "invariably is intentionally cheating" all participants by using each participant's infusion of funds, even if "made ostensibly toward a specific transaction or purpose," to pay the other participants their fraudulent returns. *In re Polaroid Corp.*, 472 B.R. 22, 35 (Bankr. D. Minn. 2012). That is what occurred here: First United was insolvent. It stole money from participants, comingled those stolen funds in its common accounts, and paid false "profits" to Alliance and Respondent Banks using those funds.

Next, the district court correctly granted summary judgment to the Receiver and against Alliance because the undisputed facts show Alliance received $1,235,308 more from First United than it transferred to it. The undisputed record shows these transfers were in furtherance of the Ponzi scheme. The court of appeals erred in ruling the "uncontested" facts established that Alliance provided "reasonably equivalent value" for its Ponzi-scheme profits because Alliance did not receive payments pursuant to the terms of the participation agreement. Instead, First United paid Alliance with stolen and commingled funds transferred so Johnston could avoid detection and perpetuate the Ponzi scheme.

Finally, the court of appeals correctly held that MUFTA actual-fraud claims are governed by the statute of limitations for "relief on the grounds of fraud" in Minn. Stat. § 541.05, subd.1(6). But the court erred in holding that MUFTA constructive-fraud claims are governed by a different subdivision—the statute of limitations applicable to a "liability created by statute" in Minn. Stat. § 541.05, subd. 1(2). This is because under *McDaniel v. United Hardware Dist. Co.*, 469 N.W.2d 84 (Minn. 1991), if the MUFTA claims are for "liabilities existing at common law which have been recognized by statute," then Section 541.05, subd. 1(6) applies. Both MUFTA actual-fraud and MUFTA constructive-fraud claims are for liabilities existing at common law that have been recognized by statute. The "core of relief under MUFTA is traceable back to the common law; and the aspects of the statutory regime that are more extensively restructured or rearticulated still have their antecedents in common law and its intermediate descendants in statute." *In re Petters Co.*, 494 B.R. 413, 434 (Bankr. D. Minn. 2013).

ARGUMENT

I. Standard of Review

This court reviews a district court's summary judgment decision de novo. *Kratzer v. Welsh Cos.,* 771 N.W.2d 14, 18 (Minn. 2009). In doing so, the court determines whether the district court properly applied the law and whether there are genuine issues of material fact that preclude summary judgment. *Riverview Muir Doran, L.L.C. v. JADT Dev. Co.,* 790 N.W.2d 167, 170 (Minn. 2010).

This court also conducts a de novo review of a district court's order dismissing claims pursuant to Minn. R. Civ. P. 12. *Bodah v. Lakeville Motor Express, Inc.*, 663 N.W.2d 550, 553 (Minn. 2003). In doing so, the question before the court is whether the complaint sets forth a legally sufficient claim for relief. *Hebert v. City of Fifty Lakes*, 744 NW2d 226, 229 (Minn. 2008). In conducting this review, the court may "consider only the facts alleged in the complaint, accepting those facts as true and must construe all reasonable inferences in favor of" the pleading party. *Bodah,* 663 N.W.2d at 553. The district court dismissed the Receiver's claims against Respondent Banks under the statute of limitations. This court reviews the "construction and application of a statute of limitations, including the law governing the accrual of a cause of action, de novo." *Park Nicollet Clinic v. Hamann*, 808 N.W.2d 828, 831 (Minn. 2011). Thus, this court reviews de novo the question of which statute of limitations applies to the Receiver's MUFTA claims. *Id.*

II. MUFTA (Minnesota's Version of the Uniform Fraudulent Transfer Act) and the Ponzi-scheme Presumption

Minnesota adopted the Uniform Fraudulent Transfer Act by enacting the MUFTA. Minn. Stat. § 513.51. Under the MUFTA, the Receiver may recover transfers First United made to Alliance and Respondent Banks that were actually or constructively fraudulent. Minn. Stat. § 513.44-.45.

Actual fraud occurs when the "debtor" (here, First United) makes a transfer "with actual intent to hinder, delay or defraud *any* creditor of the debtor." Minn. Stat. § 513.44(a)(1) (emphasis added). The MUFTA provides that certain "badges of fraud"—among other things—may be considered in determining whether the debtor acted with the requisite intent. Minn. Stat. § 513.44(b)(1)-(11). When a debtor makes a transfer with actual fraudulent intent, the transferee may avoid MUFTA liability by proving it received the transfer in good faith and for reasonably equivalent value. Minn. Stat. § 513.48(a).

Constructive fraud occurs when the debtor (First United) makes a transfer and does not receive reasonably equivalent value in return, and any of the following three circumstances also exist:

> (1) the debtor was insolvent on the date that any transfer was made, or became insolvent as a result of the transfer;
>
> (2) the debtor was engaged in business or a transaction, or was about to engage in business or a transaction, for which its property remaining after the transfer was unreasonably small in relation to the business or transaction; or
>
> (3) the debtor intended to incur, or believed that it would incur, debts that would be beyond its ability to pay as such debts matured.

Minn. Stat. §§ 513.44(a)(2), 513.45.

As the court of appeals recognized, in fraudulent-transfer actions arising out of a collapsed Ponzi scheme, courts across the country overwhelmingly use the "Ponzi-scheme presumption" in applying the UFTA's elements. (Add18-19) When a debtor operates as a Ponzi scheme, there are three effects under the UFTA. First, for actual-fraud claims, the "mere existence of a Ponzi scheme is sufficient to establish the debtor's actual intent to defraud its creditors." *Donell*, 533 F.3d at 770.

Second, for constructive-fraud claims, the existence of a Ponzi scheme establishes that the debtor "was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction," or that the debtor "intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due." *Id.* at 770-71. Thus, it establishes insolvency.

Third, for both actual- and constructive-fraud claims, a transferee (e.g., the Participant banks) cannot, as a matter of law, provide reasonably equivalent value for "profits" (amounts received in excess of the amounts paid to the debtor) that the debtor transferred to it from the Ponzi scheme. *Id.* at 772, 777-78. Courts have reasoned that when a party invests in a Ponzi scheme, it is defrauded from the outset because the fraudster presents the enterprise as a legitimate and solvent business capable of producing a profit. *See, e.g.*, *Perkins v. Haynes*, 661 F.3d 623, 627 (11th Cir. 2011). By definition, however, a Ponzi scheme is none of those things. Therefore, from its initial payments into the scheme, the party has an immediate right of action in tort for restitution. *Id.* When the investor receives a transfer that is a return of its principal, it has provided reasonably equivalent value to the debtor—a pro tanto satisfaction of its claim for restitution. *Id.* As to the amounts that exceed principal—the Ponzi-scheme's phantom "profits"—the investor has provided nothing of value to the debtor. *Id.*

To separate principal from profit, courts apply the "netting rule." Under this rule, all amounts transferred by the Ponzi-scheme operator are netted against all amounts paid in by the Participant, regardless of how the transferred funds are characterized. *Donell*, 533 F.3d at 771, 774. The earliest payments received by the participant are designated as payments of principal applied against the Participant's restitution claim. *Id.* Transfers in excess of principal are avoidable because the Participant has provided no reasonably equivalent value for such transfers. *Id.*

Among the numerous courts that have applied the Ponzi-scheme presumption to UFTA claims are Minnesota's bankruptcy court and courts analyzing the First United Ponzi scheme, including the district court in this case. *In re Polaroid Corp.*, 472 B.R. 22 (Bankr. D. Minn. 2012); *In re Petters Company, Inc.*, 499 B.R. at 356-57, 342 (Bankr. D. Minn. 2013); *Finn v. Peoples Bank of Wisc.*, 2012 U.S. Dist. LEXIS 130863 (W.D. Wis. Aug. 22, 2012); (Add 33-50).

III. The Court of Appeals Erred in Applying a Limited Version of the Ponzi-Scheme Presumption to the Receiver's MUFTA claims

Based on the undisputed fact that Johnston operated First United as a Ponzi scheme, the court of appeals accepted and applied two prongs of the Ponzi-scheme presumption to conclude: (1) First United had actual intent to defraud when it made transfers to Alliance; and (2) First United was insolvent when it made transfers to

Alliance. (Add 21-26) The court declined, however, to apply the third part of the Ponzi-scheme presumption. Without citing any relevant authority, the court stated that presuming Alliance did not provide reasonably equivalent value for its profits would create an "exception" to the MUFTA, which could only be done "by the supreme court or the legislature." (Add29) Because application of the Ponzi-scheme presumption to establish a lack of reasonably equivalent value is consistent with MUFTA and merely recognizes the legal effect of the factual circumstances present in Ponzi schemes, this holding should be reversed and the district court's order and judgment reinstated.

A. First United Was a Ponzi Scheme

First United was a Ponzi scheme from 2002 until its collapse in 2009. The district court stated: "However the parties may characterize First United's business model, … it was a Ponzi scheme. No genuine issue of material fact exists regarding that conclusion." (Add42) The court of appeals observed that "respondent banks do not dispute the district court's determination that First United was engaged in a Ponzi scheme." (Add20)

B. The Presumption of Fraudulent Intent is Consistent with the MUFTA, the Reality of Ponzi Schemes, and the First United Ponzi Scheme

Given the existence of a Ponzi scheme, a presumption that the debtor acted with fraudulent intent is consistent with the MUFTA and the reality of how Ponzi schemes are operated, including First United.

Courts have consistently held that transfers made in furtherance of a Ponzi scheme are presumed to be intentionally fraudulent. *See, e.g., Donell*, 533 F.3d at 770 ("[T]he mere existence of a Ponzi scheme is sufficient to establish actual intent to defraud.").[1] As one court explained, "One can infer intent to defraud future undertakers from the mere fact that a debtor was running a Ponzi scheme. Indeed, no other reasonable inference is possible. A Ponzi scheme cannot work forever." *In re Indep. Clearing House Co.*, 77 B.R. 843, 860 (D. Utah 1987). Minnesota's bankruptcy court has held the existence of a Ponzi scheme establishes a debtor's actual intent to hinder, delay, or defraud creditors as a matter of law when the debtor makes transfers in furtherance of the Ponzi scheme, reasoning the Ponzi-scheme presumption's "logic is unassailable; given the very ethos of a Ponzi scheme," the scheme's operator "invariably is intentionally cheating" all investors by using each investor's infusion of funds, even if "made ostensibly toward a specific transaction or purpose," to pay the other investors their fraudulent profits. *Polaroid*, 472 B.R. at 35. Indeed, there "is no cogent argument against using" the

[1] *See also Warfield v. Byron*, 436 F.3d 551, 558 (5th Cir. 2006) ("The Receiver's proof that RDI operated a Ponzi scheme established the fraudulent intent behind the transfers made by RDI."); *In re Agric. Research and Tech. Group, Inc.*, 916 F.2d 528, 538 (9th Cir. 1990) ("[T]he mere existence of a Ponzi scheme ... fulfill[s] the requirement of actual intent on the part of the debtor."); *Conroy v. Shott*, 363 F.2d 90, 92 (6th Cir. 1966) (If a Ponzi scheme exists, the "question of intent to defraud is not debatable"); *Terry v. June*, 432 F. Supp.2d 635, 639-40 (W.D. Va. 2006) (granting receiver summary judgment that transfers were made with actual intent to defraud; *In re World Vision Entm't, Inc.*, 275 B.R. 641, 656 (Bankr. M.D. Fla. 2002) ("In cases involving a Ponzi scheme, the analysis is simplified because a fraudulent intent is inferred."); *In re C.F. Foods, L.P.*, 280 B. Rev. 103, 110 (Bankr. E.D. Pa. 2002 2002); *In re Nat'l Liquidators, Inc.*, 230 B.R. 99, 109 (Bankr. S.D. Ohio 1999) (debtor's participation in a Ponzi scheme was sufficient to find actual fraudulent intent); *In re M&L_Bus. Mach. Co.*, 198 B.R. 800, 806 (Bankr. D. Colo. 1996) ("[H]aving determined the debtor to be a Ponzi scheme, the only inference to be drawn was that it had the requisite actual intent to hinder, delay or defraud."); *In re Randy*, 189 B.R. 425, 439 (Bankr. N.D. Ill. 1995) (proof of Ponzi scheme fulfills actual intent to hinder, delay or defraud); *In re Taubman* , 160 B.R. 964, 983 (Bankr. S.D. Ohio 1993) ("It is appropriate to find actual intent from the debtor's active participation in a Ponzi scheme.")

presumption to presume actual intent to defraud when the transfers are made in furtherance of a Ponzi scheme. *Id.*

Alliance and Respondent Banks have argued that the Ponzi-scheme presumption conflicts with the MUFTA by presuming intent to defraud. But the presumption does nothing more than recognize a method of proof. It does not alter the MUFTA's provisions in any way. The MUFTA provides that a debtor's transfer made "with actual intent to hinder, delay or defraud any creditor of the debtor" is avoidable. Minn. Stat. § 513.44(a)(1). The presumption simply recognizes what is true about all Ponzi schemes—transfers in furtherance of the scheme are, by the definition of "Ponzi scheme," made for the purpose of avoiding detection so that further victims can be lured to provide more money for the fraudster to steal. Then the cycle repeats. There "is no cogent argument against" the conclusion that a fraudulent intent necessarily accompanies transfers made in such circumstances. *Polaroid*, 472 B.R. at 35.

To deny that a Ponzi transfer is infected by actual fraud is to deny the existence of the Ponzi scheme itself. In this case, that argument is long foreclosed. First United "was a Ponzi scheme" and "[n]o genuine issue of material fact exists regarding that conclusion." (Add42) The Ponzi scheme existed before Alliance and Respondent Banks received their transfers from First United, which "by itself is enough to establish the transfers were made with actual fraudulent intent." *In re AFI Holding, Inc.*, 525 F.3d 700 (9th Cir. 2008). Nothing about the manner of proving fraudulent intent through the Ponzi-scheme presumption conflicts with the MUFTA.

Alliance and Respondent Banks' argument that they dealt with First United on "legitimate" loan participation transactions does not avoid the presumption that Johnston acted with fraudulent intent when he made transfers to them. First, none of First United's participation agreements were "legitimate." While First United did make some non-counterfeit loans, it is inaccurate to characterize any loan made by First United as legitimate. As the Seventh Circuit explained in *Scholes*, transfers that a Ponzi-scheme operator makes with money fraudulently stolen from others are never "legitimate":

> It is no answer that some or for that matter all of [defendant's] profit may have come from "legitimate" trades made by the corporations. They were not legitimate. The money used for the trades came from investors gulled by fraudulent representations.

56 F.3d at 757.

Here, in 2002 First United began fraudulently obtaining funds from Participants and using those funds to pay prior Participants. First United had insufficient assets to operate beyond August 2002 without funds from the Ponzi scheme. Johnston knew this. He defrauded every Participant. Even though he defrauded different Participants in different ways, no participation was "legitimate." No Participant, including Alliance and the Respondent Banks, could have received any "profits" without the scheme.

The discussion of "real" or "legitimate" loans made by First United also ignores the fact that no *participation* was free of fraud, regardless of the particular underlying loan. Once a Ponzi-scheme existed, Johnston defrauded *all* new Participants by presenting First United as a solvent, legitimate enterprise capable of producing profit. In fact, First United was insolvent and fraudulent, and its exposure at any given moment would cause all Participants to lose money. Nothing Johnston did vis-à-vis the Participants was "real" or "legitimate."

Next, as demonstrated by Alliance's transactions with First United, even when there was an "actual" (as opposed to counterfeit) loan underlying a participation agreement, First United routinely made transfers to Participants without receiving a corresponding transfer from the borrower or made transfers that exceeded the amounts paid by the borrower. Thus, First United used money stolen from other Participants to fund these transfers and perpetuate the fraud.

Further, to satisfy the MUFTA's fraudulent-intent requirement, the debtor's intent can be established as to *any* creditor. Minn. Stat. § 513.44(a)(1) ("with actual intent to hinder, delay or defraud *any* creditor") (emphasis added). The so-called "legitimacy" of an isolated transfer is meaningless in a Ponzi scheme because all transfers, by definition, are intended to perpetuate the scheme by forestalling detection. To argue that a single cherry-picked transfer was "legitimate" is to argue that no Ponzi scheme existed. Again, that argument cannot apply here. The very nature of Ponzi schemes establishes the fraudster's intent. Thus, proof that a transfer furthers a Ponzi scheme is, by definition, proof of fraudulent intent. Nothing about this method of proof contradicts the MUFTA.

The *Polaroid* court captured this point when it rejected arguments that there was a "clean side" and a "dirty side" to the Petters Ponzi scheme. The court ruled the relevant intent was harbored by "one natural person," Tom Petters, who "controlled the whole structure." 472 B.R. at 40-41. Similarly, in this case, "one natural person"—Corey Johnston—harbored the intent to defraud by making the transfers in furtherance of the

Ponzi scheme. Johnston alone controlled the whole structure. As the district court recognized in a 2011 order, no one's dealings with First United were "legitimate":

> ...the activities were performed with an eye toward perfecting an extensive fraud. To reiterate, because the overtly fraudulent activities of First United rested, by design, upon earlier legal activities, it may be imprudent to distinguish any of First United's legitimate activities from the larger scheme to defraud, and therefore all of its actions must be viewed as a cohesive attempt to profit from deception.

(A397)

The Ponzi-scheme presumption operates like one of the eleven non-exclusive badges of fraud listed in the MUFTA. *See* Minn. Stat. § 513.44(a)(1); *Polaroid*, 472 B.R. at 35 (presumption may be viewed as "one *big* badge of fraud") (emphasis in original.) As the court of appeals recognized, the Ponzi-scheme presumption of fraudulent intent is consistent with the plain language of MUFTA, is not inconsistent with legislative intent or MUFTA's broad remedial purpose, and it can be reconciled with the common law definition of "hinder, delay or defraud." (Add 21-26) The district court properly applied the Ponzi-scheme presumption to find Johnston's actual intent to defraud.

C. The Presumption of Insolvency is Consistent with the MUFTA, the Reality of Ponzi Schemes, and the First United Ponzi Scheme

Given the existence of a Ponzi scheme, the presumption that the debtor was insolvent at the time the transfers were made is consistent with the MUFTA and the reality of how Ponzi schemes are operated, including First United.

The court of appeals correctly recognized that First United was insolvent because it was a Ponzi scheme. (Add26) Indeed, Ponzi schemes are insolvent from their inception as a matter of law. *See, e.g., Cunningham v. Brown*, 265 U.S. 1, 8 (1924) (given his fraudulent scheme, Charles Ponzi "was always insolvent, and became daily more so, the more his business succeeded"); *Warfield,* 436 F.3d at 558 (proof of a Ponzi scheme is proof of insolvency, because Ponzi schemes are insolvent from their inception); *Scholes v. Lehmanan*, 56 F.3d at 755 (because "defrauded investors ... are tort creditors," Ponzi scheme entities "were insolvent from the outset"); *In re Randy,* 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995) ("Having been convicted of a Ponzi scheme, Randy was insolvent from its inception as a matter of law"); *In re Indep. Clearing House Co.*, 77 B.R. at 871 (Ponzi schemes are insolvent from inception). This conclusion cannot be disputed—a Ponzi scheme uses money from new investors to pay phantom profits to earlier investors and to unjustly enrich the scheme operator. Thus, the Ponzi-scheme entity is immediately insolvent as the result of both operator theft and the inevitable transfers of phantom profits made to keep the scheme afloat.

Further, because they are insolvent from their inception, Ponzi schemes invariably operate with property and assets that are unreasonably small in relation to their purported business. *Donell*, 533 F.3d at 770-71. Because Ponzi schemes cannot work forever, the scheme operator knows investors will lose their money. Therefore, the debtor intends to incur, or must believe that it will incur, debts beyond its ability to pay as the debts mature. *In re Indep. Clearing House Co.*, 77 B.R. at 860.

The Receiver's undisputed insolvency analysis confirms that First United was insolvent from 2002 to 2009. (A137-138) First United's insolvency was also recognized by the court of appeals in its prior decision affirming the Receiver's equitable distribution plan. *Cmty. First Bank*, 822 N.W.2d at 311. The district court properly applied the

Ponzi-scheme presumption to find First United was insolvent when it made transfers to Alliance.

D. The Presumption of Lack of Reasonably Equivalent Value is Consistent with the MUFTA, the Reality of Ponzi Schemes, and the First United Ponzi Scheme

The presumption that "profits" — transfers in excess of principal amounts invested in a Ponzi scheme — lack equivalent value flows inevitably from the nature of Ponzi schemes. As the Ninth Circuit has explained, this is because the fraudster makes all transfers for the purpose of avoiding detection by maintaining the appearance of solvency:

> Payout of "profits" made by Ponzi scheme operators are not payments of return on investment from an actual business venture. Rather, they are payments that deplete the assets of the scheme operator for the purpose of creating the appearance of a profitable business venture. The appearance of a profitable business venture is used to convince early investors to "roll over" their investment instead of withdrawing it, and to convince new investors that the promised returns are guaranteed. Up to the amount that "profit" payments return the innocent investor's initial outlay, these payments are settlements against the defrauded investor's restitution claim. Up to this amount, therefore, there is an exchange of "reasonably equivalent value" for the defrauded investor's outlay. Amounts above this, however, are merely used to keep the fraud going by giving the false impression that the scheme is a profitable, legitimate business.

Donell, 533 F.3d at 777.

In this case, the court of appeals recognized these principles and agreed that the great weight of authority supports the presumption that a participant cannot provide reasonably equivalent value in exchange for profits from a Ponzi scheme, which by definition do not exist. The court believed, however, that application of the presumption was beyond its role as an intermediate, error-correcting court. (Add29) But the Ponzi-scheme presumption merely recognizes a method of proving the elements of a MUFTA claim by recognizing what is true about all Ponzi schemes. As such, nothing about it conflicts with or supplants the MUFTA. Once the existence and furtherance of a Ponzi scheme are established—as they undisputedly have been in this case—the presumption follows. For reasons it did not explain, however, the court of appeals accepted and applied the presumption's first two prongs while rejecting the third. The district court was correct in applying the presumption to the MUFTA's reasonably equivalent value element, and its decision should be reinstated.

As explained above, the vast majority of Ponzi-scheme cases apply the "netting rule," including the court of appeals when it approved using that rule for calculating claims of First United's Ponzi-scheme victims. *Cmty. First Bank,* 822 N.W.2d at 310-13. Under the netting rule, all amounts transferred by the Ponzi scheme are netted against all amounts paid in by the participant, regardless of how the transfers are characterized. *Donell*, 533 F.3d at 771, 774. The earliest payments are designated as payments of principal and are applied against the participant's restitution claim. (*Id.*) Transfers in excess of principal are avoidable because a recipient of Ponzi scheme "profits" cannot provide reasonably equivalent value for such transfers. (*Id.*)

Alliance and Respondent Banks asserted below that the Ponzi-scheme presumption, when used in tandem with the netting rule, somehow deletes the reasonably equivalent value safe-harbor from the MUFTA. This is not so. A recipient of transfers from a Ponzi scheme may still avail itself of the reasonably equivalent value defense, but the defense will only be effective to defeat a Receiver's claims against transfers constituting a return of principal. As explained by the court in *Perkins v. Haynes*, 661 F.3d 623 (11th Cir. 2011):

> In the case of Ponzi schemes, the general rule is that a defrauded investor gives "value" to the debtor in exchange for a return of the principal amount of the investment, but not as to any payments in excess of principal. ... Courts have recognized that defrauded investors have a claim for fraud against the debtor arising as of the time of the initial investment. ... Thus, any transfer up to the amount of the principal investment satisfies the investor's fraud claim (an antecedent debt) and is made for "value" in the form of the investor's surrender of his or her tort claim. Such payments are not subject to recovery by the debtor's trustee. ... Any transfers over and above the amount of the principal – i.e., for fictitious profits – are not made for "value" because they exceed the scope of the investor's fraud claim and may be subject to recovery by a plan trustee.

661 F.3d at 627.

To the extent Alliance argues the presumption "deletes" the defense as to Ponzi-scheme "profits," this is a classic begging of the question. The defense is unavailable not because of a court-mandated "deletion"; it is unavailable because Ponzi schemes, by definition, produce no profit. Instead, the fraudster labels the transfer as "profit," but in *fact* the transfer merely depletes the fraudulent enterprise's assets to serve the fraudster's need to maintain the appearance of a solvent, profitable business venture. This is not a statutory "deletion." It is the application of facts to a statutory element. As to transfers of profit, the Participant's reasonably equivalent value defense fails not because the presumption "deletes" it from the MUFTA, but because "profits" taken from a Ponzi scheme are beyond anything of value the Participant has given to the debtor. *Donell*. 533 F.3d at 777-78.

Stated otherwise, reasonably equivalent value operates as a shield to protect innocent participants in a Ponzi scheme, but it cannot be used as a sword to profit from such a scheme. Whether as an element of the transferee's defense to an actual-fraud claim, or as an element of the Receiver's constructive-fraud claim, the transfers to Alliance and Respondent Banks in excess of amounts they paid to First United are not supported by reasonably equivalent value as a matter of law and undisputed fact.

The Seventh Circuit's analysis in *Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995) supports this conclusion. In *Scholes*, the court addressed the Ponzi-scheme presumption and rejected an investor's argument that the profits he received could be traced to "legitimate" business transactions for which he provided reasonably equivalent value. The court so ruled because a Ponzi scheme has no profits, much less "legitimate" profits. And this is true even if certain parts of the Ponzi-scheme entity appear to show a profit at certain times. As the court explained:

> The injustice in allowing [the investor] to retain his profit at the expense of the defrauded investors is avoided by insisting on commensurability of consideration. [The investor] is entitled to his profit only if the payment of that profit to him, which reduced the net assets of the estate now administered by the receiver, was offset by an equivalent benefit to the estate. It was not. A profit is not offset by anything; it is the residuum of income that remains when costs are netted against revenues. The paying out of profits to [the investor] not offset by further investments by him conferred no benefit on [the Ponzi scheme entities] but merely depleted their resources faster.

56 F.3d at 757.

The *Scholes* court expressly rejected the defendant's argument that his "profits" came from "legitimate" business operations of the Ponzi scheme and therefore were not a fraudulent transfer—the same argument the court of appeals accepted here. The defendant in *Scholes* claimed that his profits could be traced to "legitimate" commodity trades. But just as Alliance (and others) received their gains from the commingled funds stolen from others, so the money used to make the so-called "legitimate" trades in *Scholes* came from investors gulled by fraudulent representations. Such transactions are not "legitimate" because the fraudster made them to avoid detection so that further victims could be lured to provide more money for him to steal, and so that the cycle could be repeated. As the *Scholes* court stated, a participant "should not be permitted to benefit from a fraud at their expense merely because he was not himself to blame for the fraud." *Id.* at 757-58.

To be clear, there was no "legitimate" First United vs. "fraudulent" First United enterprise; there is no "clean side" vs. a "dirty side" of a Ponzi scheme. *Polaroid,* 472 B.R. at 35. To the extent there were seemingly "legitimate" transactions conducted by First United, such transactions were in furtherance of the Ponzi scheme—detection-avoiding window dressing intended to gull all investors.

Nor can Alliance claim an entitlement to profit by claiming to be a "creditor" of First United that was owed interest on an antecedent debt. Alliance was a Participant under a participation agreement with First United. As a matter of law, participation agreements are not loans. *In re Corporate Fin.*, 221 B.R. 671, 678 (Bankr. E.D.N.Y. 1998); *In re ACRO Bus. Fin. Corp.*, 357 B.R. 785, 789 (Bankr. D. Minn. 2006). Alliance's participation agreement provides the parties' relationship was that of "seller and purchaser" and "not a creditor-debtor relationship." (A247) The Agreement provides that First United was not responsible for the Borrower's performance, nor did it warrant that the Borrower would perform its loan commitments. (A248 at §3.1; A252-53 at §§5.1-5.2) Alliance was not a creditor owed contractual interest from First United or Borrower, and its transfers from First United were not mere preferences of a creditor. Indeed, Alliance expressly acknowledged in the Participation Agreement that it was an "Institutional Investor." (A248)

Finally, the label of "interest payments" that Alliance attaches to its profits does not legitimize them. How the "profit" component of the transfers was "denominated contractually" cannot change its stripes as a fraudulent transfer. *Petters*, 499 B.R. at 356. When a transfer is made in furtherance of a Ponzi scheme, there simply are no "legitimate" funds in excess of the principal invested to include in the transfer, no matter whether the transferee holds equity, debt, or some other contractual right to payment. *Id.* Instead, participants in a Ponzi scheme receive a dollar-for-dollar setoff for their tort-based restitution claims—the only "reasonably equivalent value" they provided, or could provide, to the fraudulent enterprise.

In sum, the Ponzi-scheme presumption does nothing more than provide a method of proof that recognizes the reality of Ponzi schemes—they produce no profit and the fraudster makes transfers in furtherance of the scheme with the intent to defraud other creditors. The presumption does not conflict with the MUFTA. The district court correctly applied the presumption to First United's transfers of false profits to Alliance.

E. First United's transfers to Alliance were in furtherance of the Ponzi scheme

The undisputed facts establish Alliance received transfers totaling $1,235,308 in false "profits" from First United. The district court correctly concluded that transfers of these "profits" to Alliance were "inextricably intertwined with the Ponzi scheme." (Add36, 43-44) This is undisputed because all transfers to Alliance occurred when First United was insolvent and was defrauding all Participants, whose commingled money it was using to avoid detection and perpetuate the scheme.

The court of appeals erroneously accepted Alliance's argument that First United had a "legitimate" and an "illegitimate" side, and that Alliance's "profits" came from the "legitimate" side. But as the district court correctly stated, "the true security Alliance depended on ... was First United's ability to switch money away from other unwitting investors to pay Alliance." (Add37) Indeed, in 2007—the year Alliance received all of its $1.24 million profit—First United's cumulative insolvency was $52.3 million. (A138) To keep this massive criminal insolvency from being exposed, Johnston dealt with *all* Participants, including Alliance, to further the Ponzi scheme. He made at least 23 transfers to Alliance despite receiving no underlying borrower payment. (A139) He made at least 16 transfers to Alliance in amounts that exceeded the underlying borrower payment. (A139) He stole $16 million in May 2007 and used those stolen funds to pay *all* of Alliance's profits. (A139) And he made transfers to Alliance so that the scheme would not unravel. (A139)

First United's transfers to Alliance were in furtherance of the Ponzi scheme. Johnston intended to defraud First United's creditors and Alliance received its "profits" on May 31, 2007, not in exchange for reasonably equivalent value provided to First United, but from funds Johnston stole in a $16 million fraud spree that month. The court of appeals erred in ruling that First United made "legitimate" transfer of profit to Alliance. Instead, these transfers were in furtherance of the First United Ponzi scheme.

F. Public policy supports applying the Ponzi-scheme presumption

Courts that have applied the Ponzi-scheme presumption have done so in part because of its favorable public policy. As the court explained in *In re Indep. Clearing House Co.*:

> [A]s a matter of public policy, the contracts [with the Ponzi schemer] were unenforceable to the extent they purported to give defendants a right to payments in excess of their undertaking. Consequently, transfers by the debtors [schemers] to a defendant in excess of his undertaking did not satisfy an antecedent debt of the debtors.

77 B.R. at 857-58. The rationale for this rule is irrefutable:

> If the contract were enforced, the party who received the benefits of his contract would be unjustly enriched at the expense of other defrauded undertakers. In short, to enforce the contract as to fictitious profits would only further the debtor's fraudulent scheme.

Id.

By contrast, if the court of appeals' ruling is permitted to stand, the fraudster—Johnston—will have decided who the winners and losers are in the First United Ponzi scheme. Johnston defrauded all Participants, whether they purchased a participation in a counterfeit loan, an oversold loan, or a loan with neither of those features. Nothing any Participant did dictated whether Johnston sold it one particular type of participation or another. Just as Tom Petters before him, Johnston alone "controlled the whole structure." *Polaroid*, 472 B.R. at 40-41. Johnston alone controlled who was paid and when. Johnston alone controlled when and how to infuse the scheme with new fraudulently obtained dollars. It is therefore absurd and inequitable to allow a criminal mastermind like Johnston to determine who profits from the Ponzi scheme and who bears the loss.

The absurdity and inequity of the court of appeals' holding is highlighted by the events of May 2007. First United paid Alliance $2.57 million on May 31, 2007. However, as detailed above, but for Johnston's May 2007 fraud spree, which brought in $16 million of stolen funds, First United would not have been able to pay Alliance on May 31. Thus, without Johnston's fraud, Alliance would be on the "net loser" side of the ledger and supporting the Receiver's efforts to recover its lost principal. Minnesota needs a reasoned rule of law, not the whim of a criminal mastermind, to govern MUFTA claims made in the wake of Ponzi schemes. The Ponzi-scheme presumption provides that reasoned rule of law, and this court should follow the great majority of courts to consider the issue and apply it to the Receiver's MUFTA claims.

IV. MUFTA Actual-Fraud and Constructive-Fraud Claims are Both Governed by the Statute of Limitations in Minn. Stat. § 541.05, Subd. 1(6) for Claims Seeking Relief "On the Grounds of Fraud."

Unlike the UFTA, the MUFTA does not contain a statute of limitations provision. This court has yet to address the issue, although Minnesota's bankruptcy court recently held that Minn. Stat. § 541.05, subd. 1(6), which applies to claims seeking relief "on the grounds of fraud" and contains a discovery rule, governs both MUFTA actual-fraud and constructive-fraud claims. *See In re Petters Co.*, 494 B.R. 413, 434 (Bankr. D. Minn.

2013); *see also Finn v. People's Bank of Wisc.*, 2012 U.S. Dist. LEXIS 130863, at *64-66 (W.D. Wis. Aug. 27, 2012) (subdivision 1(6) applies to MUFTA actual and constructive fraud claims).

In this case, the district court held just the opposite—that Minn. Stat. § 541.05, subd. 1(2), which governs for "liabilities created by statute," applies to the Receiver's MUFTA actual-and constructive-fraud claims. The court of appeals split the two, ruling actual-fraud claims are governed by subdivision 1(6) but constructive-fraud claims are governed by subdivision 1(2).

This court should reverse the latter ruling and a hold that both MUFTA constructive-fraud and actual-fraud claims are governed by Minn. Stat. § 541.05, subd.1(6), the statute of limitations that applies to claims for "relief on the grounds of fraud" and contains a discovery rule. As explained below, this is the correct outcome under the holding in *McDaniel v. United Hardware Dist. Co.,* 469 N.W.2d 84 (Minn. 1991). When a claim is for "liabilities existing at common law which have been recognized by statute," then subdivision 1(2) is inapplicable. 469 N.W.2d at 85. Both MUFTA actual-fraud and MUFTA constructive-fraud claims are for liabilities existing at common law. *Petters*, 494 B.R. at 421-36. As the *Petters* court reasoned, "The core of relief under MUFTA is traceable back to the common law; and the aspects of the statutory regime that are more extensively restructured or rearticulated still have their antecedents in common law and its intermediate descendants in statute." *Id. at* 434. Because subdivision 1(2) is inapplicable, subdivision 1(6) therefore applies to all MUFTA fraud claims.

A. Subdivision 1(2) Does Not Apply Because MUFTA Claims are Not Liabilities *Created* by Statute; Instead, They are Liabilities Existing at Common law which have merely been *Recognized* by Statute

Under *McDaniel*, where a claim is for "liabilities existing at common law which have been recognized by statute," then subdivision 1(2) does *not* apply. 469 N.W.2d at 85. This court recently reaffirmed *McDaniel* in *Sipe v. STS Manufacturing, Inc.*, 834 N.W.2d 683, 687 (Minn. 2013), explaining that "if an action originates at common law, it cannot be based 'upon a liability created by statute' under section 541.05, subdivision 1(2)." As detailed below, the history of Minnesota's fraudulent-transfer law shows that MUFTA is a codification of Minnesota common law. Therefore, subdivision 1(2) does not apply to MUFTA claims, and subdivision 1(6) applies instead.

1. Minnesota's first fraudulent-transfer statute codified common law

Minnesota enacted its first fraudulent transfer statute in 1858, when the legislature declared that "[e]very conveyance or assignment in writing or otherwise, or any estate or interest in lands or of goods, chattels, or things in action, or of any rents, issues or profits, made *with the intent to hinder, delay or defraud creditors* ... shall be void." Minn. Stat. Ch. 51, § 1 (1858) (emphasis added). From the outset, this court recognized that Minnesota's fraudulent transfer statute was a codification of common law. In *Blackman v. Wheaton*, 13 Minn. 326 (1868), this court held "[t]he statute of 13 Eliz. C. 5, and the statute of our state rendering void certain conveyances made with a fraudulent intent, are but declaratory of the common law." *Id.* at 330.[2]

2. After the legislature amended the statute, some fraudulent transfer claims reverted to the common law for 63 years

Five years after codifying the common law of fraudulent conveyances, the legislature deleted the phrase "goods, chattels, or things in action" from chapter 51. *Blackman*, 13 Minn. at 331. This repeal, however, did not eliminate liability for fraudulent transfers involving "goods, chattels, or things in action." Instead, liability for such transfers reverted to the pre-existing common law. *Id.* (deletion of "goods, chattels and things in action" from statute did not change common law rule against fraudulent transfers involving non-real estate).

The legislature did not address fraudulent transfers of personal property again until 1921, when it enacted the Minnesota Uniform Fraudulent Conveyance Act ("MUFCA"). In the intervening 63 years between 1858 and 1921, when only the common law applied, this court repeatedly recognized *both* actual fraudulent transfer claims and constructive fraudulent transfer claims by implying the debtor's fraudulent intent based on the debtor's economic circumstances. *See, e.g., Sovell v. Lincoln County*, 152 N.W. 727, 727-28 (Minn. 1915) (affirming judgment avoiding transfer made with actual intent to defraud creditor); *Underleak v. Scott*, 134 N.W. 731, 733 (Minn. 1912) (holding debtor's fraudulent intent may be "implied *conclusively* from the circumstances surrounding the

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[2] The Statute of Elizabeth is a codification of English common law, providing transfers made with the "purpose and intent, to delay, hinder or defraud creditors and others of their just and lawful actions," can be avoided. 13 Eliz., *Ch. 5* § 1 (1571).

transfer, as where a debtor is insolvent, or fails to retain sufficient property to amply satisfy existing claims against him") (emphasis added). If Minnesota common law did not recognize constructive-fraud claims, they would have ceased to exist as to personal property transfers for these 63 years. Clearly they did not.

As a leading commentator at the time explained, before the legislature enacted MUFCA in 1921, Minnesota courts "held that where a person is insolvent and makes a voluntary conveyance, the necessary effect of his act is to defraud creditors, and the debtor will be presumed to have intended this necessary effect." Donald E. Bridgman, *Uniform Fraudulent Conveyance Act in Minnesota,* 7 Minn. L. Rev. 530, 530 (1922-23) (citing *Henry v. Himnan,* 25 Minn. 199 (1878); *Walsh v. Byrnes*, 40 N.W. 831 (Minn. 1888); *McCord v. Knowlton*, 82 N.W. 589 (Minn. 1900); *Thysell v. McDonald*, 159 N.W. 958 (Minn. 1916)). And as this court explained in *Nat'l Sur. Co. v. Wittich*, 237 N.W. 690, 692 (Minn. 1931), prior to MUFCA in 1921, Minnesota's common law recognized a constructive fraudulent transfer claim.

Importantly, during this 63-year period, Minnesota courts applied the discovery rule for accrual of the six-year statute of limitations for fraudulent transfer claims, relying on the predecessor to Minn. Stat. § 541.05, subd. 1(6). *See, e.g. Schmitt v. Hager,* 93 N.W. at 110, 111 (Minn. 1903) (fraudulent conveyance claim must be commenced within six years of discovery); *Brasie v. Minneapolis Brewing Co.*, 92 N.W. at 340, 342 (Minn. 1902) (same); *Duxbury v. Boice,* 72 N.W. 113 at 839-40 (Minn. 1897) (same). Thus, both actual and constructive fraudulent transfer claims existed at common law and were subject to a six-year statute of limitations with the discovery rule.

3. MUFTA and MUFCA codified existing common-law claims

The history of MUFCA and its modern-day successor, MUFTA, shows these statutes codified Minnesota common law. The origins of MUFCA trace to the 1918 National Conference of Commissioners on Uniform State Laws (the "NCCUSL"), which recognized that many states, including Minnesota, already recognized constructive fraudulent transfer claims by implying fraudulent intent from the debtor's economic circumstances (e.g., insolvency) at the time of the transfer. UFCA, Prefatory Note, 7A U.L.A. Part II, p. 247. In recognition of this common law, the NCCUSL drafted the UFCA. *See* Record of Twenty-Eighth Meeting of NCCUSL, August 22-28, 1918, UFCA, § 4 n. 1. The NCCUSL explained that "our courts had usually treated a voluntary conveyance by an insolvent as raising an 'irrebuttable presumption of fraudulent intent.'" *Id.* The NCCSL also noted that "[c]ertain conveyances which the courts have in practice condemned, such as a gift by an insolvent, are declared fraudulent irrespective of intent." UFCA, Prefatory Note, 7A U.L.A. Part II, p. 247. The UFCA codified these common-law decisions by providing for claims based on constructive fraud: "Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration." UFCA § 4.

After it was enacted, this court recognized that MUFCA was a codification of existing substantive common law and that it provided new procedural devices, explaining that MUFCA was "a *codification* and an extension of former law. The new act simply adds an efficient, optional, and additional remedy to a creditor who has not reduced his claim to judgment." *Lind v. O.N. Johnson Co.,* 282 N.W. 661, 667 (Minn. 1938) (emphasis added); *see also State v. Thibert,* 279 N.W.2d 53, 57 (Minn. 1979) (under "pre-UFCA law in Minnesota, a voluntary conveyance by an insolvent ... was presumptively fraudulent."). The additional remedy identified in *Lind* permitted a creditor to pursue a fraudulent transfer claim before judgment; it did not alter the fact that, both before and after MUFCA was enacted, actual and constructive fraudulent transfer claims existed under Minnesota law. *Petters*, 494 B.R. at 429-30. Thus, MUFCA created only a new *remedy*; it did *not* create new *liability* in Minnesota. *Id.*

In 1987, Minnesota replaced MUFCA with MUFTA. The MUFTA preserved "[t]he basic structure and approach of [MUFCA]," and made changes only where needed to be consistent with other law. *See* UFTA, Prefatory Note, U.L.A., 7A, part II, p. 5. Courts applying Minnesota law have held that MUFTA was a codification of Minnesota common law. *Petters*, 494 B.R. at 421-36; *In re Michener,* 217 B.R. 263, 268 (Bankr. D. Minn. 1998). Consistent with this fact, MUFTA did not alter the liabilities for actual or constructive fraudulent transfer claims (e.g., transfers by an insolvent debtor) that were available under MUFCA. *Compare* Minn. Stat. § 513.23-.26 (1986) *with* Minn. Stat. § 541.44-.45 (1987). Because these statutes did not *create* the liabilities provided for therein, subdivision 1(2)--"governing liabilities *created* by statute" has no application here.

4. The Legislature Declined to Amend the Statute of Limitations Governing Actual and Constructive Fraudulent Transfer Claims when it Enacted MUFTA

When the Legislature enacted MUFTA in 1987, it could have replaced the existing six-year statute of limitations and discovery rule with the shorter limitations period set forth in the Model Act, but it chose not to do so. Specifically, UFTA Section 9 provided for a four-year limitations period for actual and constructive fraudulent transfer claims, including a one-year discovery rule. UFTA § 9. Under existing Minnesota case law, however, plaintiffs had six years from the discovery of fraudulent transfer claims to commence suit. *See, e.g., Schmitt,* 93 N.W. at111; *Brasie*, 92 N.W. at 342; *Duxbury,* 72 N.W. at 839-40; *Palatine Nat'l Bank,* 97 B.R. at 539-40. Although presented with the opportunity to adopt the four-year limitations period in Section 9, the legislature chose to leave the law unchanged.

Forty-three states and the District of Columbia have adopted the UFTA. 7A Uniform Fraudulent Transfers Act (U.L.A.), Part II, pp. 2-3. Of these jurisdictions, "at least sixteen have made substantive non-uniform amendments to the limitations periods prescribed by Section 9." Kenneth C. Kettering, *Codifying A Choice of Law Rule For Fraudulent Transfer: A Memorandum To The Uniform Law Commission,* 19 Am. Bankr. Inst., L. Rev. 319, 333 (2011). While diverse, these changes have largely lengthened or shortened the limitations periods for actual or constructive fraud claims or insider preference claims. *Id.* at 333-34, n. 60-62. Virtually all the states enacted the UFTA with some form of the discovery rule. *Id.*

Minnesota, however, is the only jurisdiction whose legislature deleted Section 9 in full. *Id.* at n. 63 ("Minnesota deleted Section 9 altogether, leaving the limitation period to other law which among other things may not operate to extinguish the claim."). In doing so, the legislature chose to retain not only the existing limitation period for common-law fraud applicable to both actual and constructive fraudulent transfer claims, but also the corresponding discovery rule. *See Pecinovsky v. AMCO Ins. Co.*, 613 N.W.2d 804, 809 (Minn. Ct. App. 2000) ("Courts presume that the legislature acts with full knowledge of previous statutes and existing case law.") When the legislature affirmatively declined to adopt Section 9, it did not make Minnesota an outlier among the jurisdictions enacting UFTA by isolating this state as the only one not to have a discovery rule for all fraud claims actionable under the UFTA. Instead, because existing Minnesota law already provided for a limitations period with a discovery rule for all types of fraudulent-transfer claim, Section 9 was unnecessary. This further establishes that subdivision 1(6) was and continues to be the applicable limitations period for both actual and constructive fraudulent transfer claims.

B. Case Law From Other Jurisdictions Supports The Application Of Subdivision 1(6) to MUFTA claims

Minnesota's bankruptcy court and a federal court in Wisconsin have both squarely held that subdivision 1(6) applies to MUFTA fraudulent transfer claims. *Petters*, 494 B.R. at 421-36; *Finn v. Peoples Bank of Wisc.*, 2012 U.S. Dist. LEXIS 130863, at *65-66. This court should follow these courts' sound reasoning and rule similarly. In addition, courts in other states have consistently held that fraudulent transfer claims existed at common law and that UFCA and UFTA statutes enacted in those states did not create new liabilities. *See, e.g., Orr v. Kenderhill Corp.*, 991 F.2d 31, 34 (2d Cir. 1993) (limitations period applicable to liability created by statute does not apply to claims under New York's fraudulent conveyance statute because fraudulent conveyance actions existed at common law); *In re Taubman,* 160 B.R. at 989; *United States v. Shepherd,* 834 F. Supp. 175, 178 (N.D. Tex. 1993) *rev'd on other grounds,* 23 F.3d 923 (5th Cir. 1994) (citing *Hadlock v. Eric,* 23 F. Supp. 692, 693 (S.D.N.Y. 1938)) ("The principles codified by the UFTA and its predecessor ... were established by case law prior to their effective dates and, indeed, the right to recovery for fraudulent conveyances is a common law right which exists independent of statute."); *Hadlock,* 23 F. Supp. at 693-94 (rejecting defendant's argument that limitations period applicable to actions "to recover upon a liability created by statute" applied, because New York's statutory debtor and creditor law did not "itself create new liabilities but was a codification of and the embodiment of existing presumptions ... those cases holding that a voluntary conveyance made while the one transferring was in debt or insolvent, was presumably fraudulent"). These cases further support the conclusion that subdivision 1(6) applies to MUFTA fraudulent transfer claims.

C. The Court of Appeals Erroneously Held That Subdivision 1(2) Applies to MUFTA Constructive Fraud Claims

The court of appeals erroneously held that subdivision 1(2) applies to MUFTA constructive fraud claims based on its mistaken conclusion that MUFTA somehow "created" constructive fraud claims that did not exist at common law. As shown by the history detailed above, Minnesota common law in fact recognized constructive fraud claims under which courts presumed, often conclusively, that debtors acted with fraudulent intent when they engaged in certain transfers when certain circumstances existed, regardless of the debtor's actual intent. *See, e.g., Underleak*, 134 N.W. at 733 (debtor's fraudulent intent may be "implied *conclusively* from the circumstances surrounding the transfer, as where a debtor is insolvent, or fails to retain sufficient property to amply satisfy existing claims against him") (emphasis added). This is the very definition of "constructive fraud"—fraud the law presumes based on circumstances existing at the time of the transfer even if the recipient could somehow prove the debtor did not actually harbor such fraudulent intent. *Id.*; *Peters,* 494 B.R. at 430-32.

D. The District Court Erroneously Relied on Consumer Fraud Law to Rule that Subdivision 1(2) Applies to MUFTA Claims

In ruling that subdivision 1(2) applies to MUFTA claims, the district court erroneously relied upon cases holding that consumer fraud statutes create new liabilities and are thereby governed by statute of limitations applicable to statutory claims. (Add 46-47) Consumer fraud statutes, however, are not analogous to the MUFTA because they plainly create new liabilities not recognized at common law: "Consumer protection laws were not intended to codify the common law; rather they were intended to broaden the cause of action to counteract the disproportionate bargaining power present in consumer transactions." *State by Humphrey v. Alpine Air Prods., Inc.*, 490 N.W.2d 888, 892 (Minn. Ct. App. 1992) *aff'd,* 500 N.W.2d 788, 790 (Minn. 1993). The effect of enacting consumer fraud statutes was the *elimination* of certain required elements of "common law fraud, such as proof of damages or reliance on misrepresentation." *Group Health Plan, Inc. v. Philip Morris Inc.*, 621 N.W.2d 2, 12 (Minn. 2001). By contrast, MUFTA codified existing fraudulent transfer claims under Minnesota common law that were not created by statute.

CONCLUSION

The court of appeals should be reversed and the district court's order granting summary judgment against Alliance should be affirmed. The district court properly applied the Ponzi-scheme presumption to hold the Receiver proved that Alliance received fraudulent transfers totaling $1,235,388 in excess of the amounts it provided First United.

The district court's order dismissing the Receiver's MUFTA claims against Respondent Banks as untimely under the statute of limitations should be reversed and the case should be remanded. The limitations period in Minn. Stat § 541.05, subd. 1(6), governs the Receiver's MUFTA claims. The Receiver's action against the Respondent Banks was commenced within six years of the discovery of the fraud, and therefore the Receiver's claims are timely.

Respectfully submitted,

Dated December 13, 2013

SWEENEY & MASTERSON, P.A.

Larry B. Ricke, #121800
Karl E. Robinson, #0274045
Suite 600, Degree of Honor Building
323 Cedar Street
St. Paul, MN 55101
(615) 223-8000

MEAGHER & GEER, P.L.L.P.

William M. Hart, #150526
33 South Sixth Street, Ste. 4400
Minneapolis, MN 55402
(612) 338-0661

Attorneys for Appellants Patrick Finn and Lighthouse Management Group, Inc.

Certificate of Compliance

This brief complies with the word limitations in Minn. R. App. P. 132.01, subd. 3(a). The brief was prepared using Microsoft Word 2010, which reports that the brief contains 13,684 words.

Karl E. Robinson

OFFICE OF APPELLATE COURTS

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County of Hennepin	)	

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Minneapolis, MN 55402

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SERVICE LIST

Kevin M Decker (#0314341)
Benjamin E. Gurstelle (#0389968)
BRIGGS AND MORGAN, P.A.
2200 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
Telephone No. (612) 977-8400
Email: kdecker@briggs.com
Email bgurstelle@briggs.com
Attorneys for Respondent Home Federal Bank

Shari L. J. Aberle (#0306551)
Andrew B. Brantingham (#0389952)
DORSEY & WHITNEY LLP
50 South Sixth Street, Suite 1500
Minneapolis, MN 55402-1498
Telephone No. (612) 340-2600
Email: aberle.shari@dorsey.com
Attorneys for Respondent KleinBank

Keith S. Moheban (#216380)
Peter J. Schwingler (#388909)
LEONARD, STREET AND DEINARD
Professional Association
150 South Fifth Street, Suite 2300
Minneapolis, MN 55402
Telephone No. (612) 335-1500
Email: keith.moheban@leonard.com
Email: peter.schwingler@leonard.com
Attorneys for Respondent M&I Marshall & Ilsley Bank

Christopher R. Morris (#230613)
BASSFORD REMELE, P.A.
33 South Sixth Street, Suite 3800
Minneapolis, MN 55402-3707
Telephone No. (612) 376-1627
Fax No. (612) 746-1227
Email: cmorris@bassford.com
Attorneys for Alliance Bank

Mark A. Merchlewitz (#0143832)
BENSON & MERCHLEWITZ
174 Main Street
Winona, MN 55987
Telephone No. (507) 454-3752
Email: mark@merchlewitzlaw.com
Attorneys for Respondent Merchant's Bank

Richard T. Thomson (#109538)
Amy L. Schwartz (#0339350)
Tyler D. Candee (#0386598)
LAPP, LIBRA, THOMSON, STOEBNER
& PUSCH, CHARTERED
120 South Sixth Street, Suite 2500
Minneapolis, MN 55402
Telephone No. (612) 338-5815
Fax No. (612) 338-6651
Attorneys for Amicus Curiae City National Bank

Steven E. Wolter (#170707)
KELLEY, WOLTER & SCOTT, P.A.
Centre Village Offices
431 South Seventh Street, Suite
2530 Minneapolis, MN 55415
Telephone No. (612) 371-9090
Fax No. (612) 371-0574
Attorneys for Amicus Curiae Douglas A. Kelley, as Chapter 11 Trustee of Petters Company, Inc., et al.

Thomas H. Boyd (#0200517)
Michael A. Rosow (#310724)
WINTHROP & WEINSTINE, P.A.
225 South Sixth Street, Suite 3500
Minneapolis, MN 55402
Telephone No. (612) 604-6400
Fax No. (612) 604-6800
Attorneys for Amicus Curiae DZ Bank AG, Deutsche Zentral Genossenschaftsbank, Frankfurt Am Main

Kevin D. Hofman (#179978)
HALLELAND HABICHT PA
33 South Sixth Street, Suite 3900
Minneapolis, MN 55402
Telephone No. (612) 836-5500
Fax No. (612) 836-5599
Attorneys for Amicus Curiae Highland Bank and Voyager Bank

David E. Runck (#0289954)
Connie A. Lahn (#0269219)
FAFINSKI MARK & JOHNSON, P.A.
400 Flagship Corporate Center
775 Prairie Center Drive
Eden Prairie, MN 55344
Telephone No. (952) 995-9500
Fax No. (9520 995-9577
Attorneys for Amicus Curiae Official Committee of Unsecured Creditors of Petters Company, Inc., et al.

H. Peter Haveles, Jr.
KAYE SCHOLER LLP
425 Park Avenue
New York, NY 10022-3598
Telephone No. (212) 836-7604
Attorneys for Amicus Curiae DZ Bank AG, Deutsche Zentral Genossenschaftsbank, Frankfurt Am Main

Joseph G. Petrosinelli
Jonathan M. Landy
Christopher J. Mandernach (#0389089)
WILLIAMS & CONNOLLY LLP
725 Twelfth Street, N.W.
Washington, D.C. 20005
Telephone No. (202) 434-5000
Fax No. (202) 434-5029
Email: jpetrosinelli@wc.com
Attorneys for Amicus Curiae Opportunity Finance, LLC

Daniel E. Reidy
Theodore T. Chung
Tara A. Fumerton
JONES DAY
77 West Wacker
Chicago, IL 60601
Telephone No. (312) 782-3939
Fax No. (312) 782-8585
Email: dereidy@jonessday. com
Email: ttchung@jonesday.com
Email: tfumerton@jonesday. com
Attorneys for Amicus Curiae Epsilon/Westford Defendants

Bruce Jones (#179553)
FAEGRE BAKER DANIELS LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402-3901
Telephone No. (612) 766-7000
Attorneys for Amicus Curiae Minnesota Defense Lawyers Association

James P. Conway (#0391044)
JASPERS, MORIARTY & WALBURG, P.A.
206 Scott Street
Shakopee, MN 55379
Telephone No. (952) 445-2817
Attorneys for Amicus Curiae Epsilon/Westford Defendants

Brian C. Kiernan
Brian D. McDonald
JONES DAY
555 California Street, 26th Floor
San Francisco, CA 94101
Telephone No. (415) 626-3939
Fax No. (415) 875-5700
Email: dkiernan@jonesday.com
Email: bdmcdonald@jonesday.com
Attorneys for Amicus Curiae Epsilon/Westford Defendants

Bruce J. Douglas (#023966)
OGLETREE, DEAKINS, NASH, SMOAK & STEWART, P.C.
3800 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
Telephone No. (612) 336-6858
Fax No. (612) 339-0061
Email: bruce.douglas@ogletreedeakins.com
Attorneys for Amicus Curiae JPMorgan Chase Bank N.A.

David Woll (NY #2213155)
Isaac Rethy (NY #4780912)
SIMPSON THACHER & BARTLETT LLP
425 Lexington Avenue
New York, NY 10017-3954
Telephone No. (212) 455-3136
Fax No. (212) 455-2502
Email: dwoll@stblaw.com
Email: irethy@stblaw.com
Of Counsel Attorneys for Amicus Curiae JPMorgan Chase Bank N.A.

Frederick H. Miller (#392030)
Craig P. Miller (#26961X)
GRAY PLANT MOOTY MOOTY & BENNETT, P.A.
500 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
Telephone No. (612) 632-3000
Attorneys for Amicus Curiae The Clearing House Association L.L.C.

Michael Freedman (CA #264041)
SIMPSON THACHER & BARTLETT LLP
1999 Avenue of the Stars, 29th Floor
Los Angeles, CA 90067
Telephone No. (310) 407-7530
Fax No. (310) 407-7502
Email: mfreedman@stblaw.com
Of Counsel Attorneys for Amicus Curiae JPMorgan Chase Bank N.A.

Karen E. Wagner
Andrew S. Gehring
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
Telephone No. (212) 450-4000
Attorneys for Amicus Curiae The Clearing House Association L.L.C.