Nos. A12-1930 and A12-2092

State of Minnesota
In Supreme Court

Patrick Finn and Lighthouse Management Group, Inc., Petitioners
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.

BRIEF OF AMICI CURIAE DOUGLAS A. KELLEY, AS CHAPTER 11 TRUSTEE AND THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF PETTERS COMPANY, INC. AND PETTERS GROUP WORLDWIDE, LLC

Steven E. Wolter (#170707)
KELLEY & WOLTER & SCOTT, P.A.
Centre Villages Offices, Suite 2530
431 South Seventh Street
Minneapolis, MN 55415
(612) 371-9090

Attorneys for Amicus Curiae Douglas A. Kelley, as Chapter 11 Trustee of Petters Company, Inc., et al.

Connie A. Lahn (#269219)
David E. Runck (#289954)
FAFINSKI MARK & JOHNSON, P.A.
775 Prairie Center Drive, Suite 400
Eden Prairie, MN 55344
(952) 995-9500

Attorneys for Amicus Curiae Official Committee of Unsecured Creditors of Petters Company, Inc., et al.

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

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

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

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

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

Attorneys for Respondent 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

Attomrys for Respondent Home Federal Bank

Shari L. J. Aberle (#0306551)
Erin Collins (#0388967)
Andrew B. Brattingham (#0389952)
DORSEY & WHITNEY LLP
50 South Sixth Street, Suite 1500
Minneapolis, MN 55402-1498
(612) 340-2600

Attorneys for Respondent KleinBank

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

Attorneys for Respondent Merchants Bank

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

Attorneys for Respondent M&I Marshall & Ilsley Bank

Thomas H. Boyd (#200517)
Michael A. Rosow (#0317998)
WINTHROP & WEINSTINE, P.A.
225 South Sixth Street, Suite 3500
Minneapolis, MN 55402
(612) 604-6400

Attorneys for Amicus Curiae DZ Bank AG, Deutsche Zentral Genossenschaftsbank, Frankfurt Am Main

James P. Conway, (#0391044)
JASPERS, MORIARTY & WALBURG, P.A.
206 Scott Street
Shakopee, MN 55379
(952) 445-2817

Attorneys for Amicus Curiae Epsilon/Westford

David C. Kiernan
Brian D. McDonald
JONES DAY
555 California Street, 26th Floor
San Francisco, CA 94101
(415) 626-3939

Attorneys for Amicus Curiae Epsilon/Westford

Bruce J. Douglas (#023966)
OGLETREE, DEAKINS, NASH, SMOAK & STEWART, P.C.
Wells Fargo Center
90 South Seventh Street, Suite 3800
Minneapolis, MN 55402
(612) 336-6858

Attorneys for Amicus Curiae JPMorgan Chase Bank, N.A.

H. Peter Haveles, Jr.
KAYE SCHOLER LLP
425 Park Avenue
New York, NY 10022-3598
(212) 836-7604

Attorneys for Amicus Curiae DZ Bank AG, Deutsche Zentral Genossenschaftsbank, Frankfurt Am Main

Daniel E. Reidy
Theodore T. Chung
Tara A. Fumerton
JONES DAY
77 West Wacker
Chicago, IL 60601
(312) 782-3939

Attorneys for Amicus Curiae Epsilon/Westford

Joseph G. Petrosinelli
Jonathan M. Landy
Christopher J. Mandernach (#0389089)
WILLIAMS & CONNOLLY LLP
725 Twelfth Street, N.W.
Washington D.C. 20005
(202) 434-5000

Attorneys for Amicus Curiae Opportunity Finance, LLC.

David Woll
Isaac Rethy
SIMPSON THACHER &
BARTLETT LLP
425 Lexington Avenue
New York, NY 10017-3954
(212) 455-3136

Attorneys for Amicus Curiae JPMorgan Chase Bank, N.A.

Michael Freedman
SIMPSON THACHER &
BARTLETT LLP
1999 Avenue of the Stars- 29th floor
Los Angeles, CA 90067
(310) 407-7530

Attorneys for Amicus Curiae JPMorgan Chase Bank, N.A.

Frederick H. Miller (#392030)
Craig P. Miller (#26961X)
GRAY PLANT MOOTY &
BENNETT, P.A.
500 IDS Center
80 South Eighth Street
Minneapolis, MN 55402

Attorneys for Amicus Curiae The Clearing House Association L.L.C.

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
(612) 338-5815

Attorneys for Amicus Curiae Highland Bank and Voyager Bank

Bruce Jones (#179553)
FAEGRE BAKER DANIELS LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 766-7000

Attorneys for Amicus Curiae Minnesota Defense Lawyers Association

Karen E. Wagner
Andrew S. Gehring
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
(212) 450-4000

Attorneys for Amicus Curiae The Clearing House Association L.L.C.

Kevin D. Hofman (#179978)
HALLELAND HABICHT P.A.
33 South Sixth Street, Suite 3900
Minneapolis, MN 55402
(612) 836-5500

Attorneys for Amicus Curiae City National Bank

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INTEREST OF AMICI CURIAE[1]

For approximately thirteen years, Thomas J. Petters ("Petters") master-minded the largest Ponzi scheme in Minnesota history. Petters posed as a successful businessman engaged in the business of buying consumer electronics at a discount and reselling this merchandise to retailers for a profit. To finance his activities, Petters and his companies, Petters Company, Inc. ("PCI") and Petters Group Worldwide, LLC ("PGW"), borrowed money from lenders using the merchandise as collateral. Throughout the scheme, Petters and his companies borrowed approximately $40 billion, and they paid billions of dollars (including hundreds of millions of dollars in fictitious profits) to various lenders in the form of loan repayments.

In 2008, it was discovered that Petters was operating a massive Ponzi scheme. Instead of paying lenders with legitimate earnings from his business, Petters fraudulently induced lenders to loan him money, and then used the stolen funds to pay earlier loans, conceal his fraud, and prolong the scheme. In 2008, when the scheme collapsed, many of Petters' lenders—who invested earlier in the scheme—received payment in full of their loans, plus hundreds of millions of dollars in fictitious profits. Others, however, who invested later, suffered devastating losses in the total amount of approximately $3 billion. Due to the size of their losses, many of Petters' victims have been forced to file for bankruptcy.

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[1] The Trustee and Creditors' Committee certify that this brief was not authored in whole or in part by counsel for any party to this appeal, and that no other person or entity contributed monetarily towards its preparation or submission.

Today, Douglas A. Kelley, the court-appointed trustee for PCI and PGW ("Trustee"), is pursuing approximately 200 lawsuits against those who profited from Petters' scheme. Primarily, these lawsuits seek to recover hundreds of millions of dollars in fictitious profits that Petters paid to early investors so they can be shared equally by all of his victims. In virtually all of these cases, the Trustee seeks to recover these funds as fraudulent transfers under the Minnesota Uniform Fraudulent Transfer Act, Minn. Stat. §§ 513.41–513.51 ("MUFTA"). Like other victims of Ponzi schemes, the ability of Petters' victims to recover from his fraud depends largely on the Trustee's ability to pursue these actions.

INTRODUCTION

A Ponzi scheme is an insidious form of fraud that creates fictitious profits for some and devastating losses for others. Ponzi schemes involve the payment of fictitious returns to existing investors from funds stolen from new investors. By definition, therefore, Ponzi schemes artificially reward early investors at the expense of later ones. All investors (both early and late) are attracted to the scheme by false representations and the promise of attractive returns. While the scheme is concealed, early investors (i.e., the "net winners") receive repayment of their original investments plus fictitious profits, comprised of other investors' stolen money. Later investors, however, lose their money when the scheme collapses. As a result, despite being similarly situated as investors in the fraud, later investors in a Ponzi scheme suffer devastating losses compared to their earlier counterparts.

Faced with this stark difference in recovery, courts uniformly hold that, in a Ponzi scheme, "equality is equity" and all investors should be treated equally.[2] Fraudulent transfer actions—like the Receiver's lawsuits in this case—are an essential tool for achieving this result. In Ponzi schemes, victims rely on MUFTA to avoid the debtor's payments of fictitious profits and recover their stolen funds. Importantly, however, because Ponzi schemes frequently are concealed for many years before they are discovered, application of the "discovery rule" to MUFTA is necessary for victims to obtain any recovery once the scheme collapses.

Similarly, because Ponzi schemes are, by definition, insolvent and investors will necessarily lose their money, all transfers in furtherance of the scheme are made "with actual intent to hinder, delay, or defraud" present or future creditors of the debtor. Once a Ponzi scheme is established, therefore, it is appropriate to apply the "Ponzi scheme presumption" to such transfers—i.e., to conclude that all payments made in furtherance of the scheme are made "with actual intent to hinder, delay, or defraud" creditors under Minn. Stat. § 513.44(a)(1).

In Minnesota, Corey Johnston's and Thomas Petters' Ponzi schemes have caused devastating losses for victims in the millions (and, in Petters' case, *billions*) of dollars. The ability to pursue fraudulent transfers under MUFTA is critical to unwind these frauds and obtain a recovery for victims. For this reason, the Trustee and the Creditors'

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2 *See, e.g.*, *Cunningham v. Brown*, 265 U.S. 1, 13 (1924); *S.E.C. v. Infinity Group Co.*, 226 Fed. Appx. 217, 218 (3d Cir. 2007); *S.E.C. v. Credit Bancorp, Ltd.*, 290 F.3d 80, 89 (2d Cir. 2002); *S.E.C. v. Byers*, 637 F. Supp. 2d 166, 176 (S.D.N.Y. 2009).

Committee respectfully ask that this Court conclude: (1) that fraudulent transfers actions under MUFTA are governed by Minn. Stat. § 541.05, Subd. 1(6), and the discovery rule therefore applies; and (2) that all payments made in furtherance of a Ponzi scheme are made "with actual intent to hinder, delay, or defraud" creditors under Minn. Stat. § 513.44(a)(1). Finally, based on the record below, the Court should reverse the Court of Appeals' decision not to apply the Ponzi scheme presumption to the transfers made to Alliance, and its conclusion that Alliance gave reasonably equivalent value in exchange for its profits received from the scheme. As a matter of law, these transfers were not made for value, and as a result, they may be avoided as a fraudulent transfer.

ARGUMENT

I. THE RECEIVER'S CLAIMS TO RECOVER TRANSFERS MADE WITH ACTUAL INTENT TO HINDER, DELAY OR DEFRAUD CREDITORS ARE GOVERNED BY MINN. STAT. § 541.05, SUBD. 1(6).

In Count One of his complaint, the Receiver seeks to avoid transfers that Corey Johnston ("Johnston") and First United Funding, LLC ("First United") made with actual intent to hinder, delay, or defraud their creditors. (A35–36)[3] Under Minn. Stat. § 513.44(a)(1), transfers made "with actual intent to hinder, delay, or defraud any creditor of the debtor" are fraudulent and may be avoided by the debtor's present and future creditors. *See* Minn. Stat. § 513.44(a)(1) (2013). Because these claims are claims for relief "on the ground of fraud," they are subject to the statute of limitations of Minn. Stat. § 541.05, Subd. 1(6), and the discovery rule. *See Minneapolis Threshing Mach. Co. v.*

[3] "A" refers to Appellants' Appendix.

Jones, 94 N.W. 551, 552 (Minn. 1903); *Schmitt v. Hager*, 93 N.W. 110, 111 (Minn. 1903); *Brasie v. Minneapolis Brewing Co.*, 92 N.W. 340, 342 (Minn. 1902); *Duxbury v. Boice*, 72 N.W. 838, 839–840 (Minn. 1897); *McMillan v. Cheeney*, 16 N.W. 404, 405 (1883) (holding that fraudulent conveyance claims must be commenced within six years, and the cause of action accrues when the facts constituting the fraud are discovered).

In determining which statute of limitations applies to the Receiver's claims, the Minnesota Supreme Court's decision in *McDaniel v. United Hardware Distributing Co.*, 469 N.W.2d 84 (Minn. 1991), provides helpful instruction. In *McDaniel*, the plaintiff brought an action for civil damages against his former employer under Minn. Stat. § 176.82, alleging he was wrongfully discharged in retaliation for seeking workers' compensation benefits. *McDaniel*, 469 N.W.2d at 84–85. The trial court and the Court of Appeals disagreed over which statute of limitations applied to the plaintiff's claim. *Id.* at 85. On appeal, this Court held that the plaintiff's claim under Minn. Stat. § 176.82 was an action "upon a liability created by statute," and the six-year limitations period of Minn. Stat. § 541.05, Subd. 1(2) applied. *Id.* at 85–86.

In reaching this conclusion, the *McDaniel* Court reasoned that Section 541.05, Subd. 1(2), "applies to liabilities imposed by statute, not to liabilities existing at common law which have been recognized by statute." *Id.* at 85. Applying this reasoning, the Court stated that Minn. Stat. § 176.82 created the plaintiff's cause of action, and that the Minnesota legislature enacted Section 176.82 more than a decade before the Court recognized an action at common law. *Id.* Based on this history, the Court held that the plaintiff's claim was a "liability created by statute" and was not a codification of the common law. *Id.* at 86. Therefore, Minn. Stat. § 541.05, Subd. 1(2), applied.

In this appeal, unlike the retaliatory discharge claims in *McDaniel*, the Receiver's claims to avoid fraudulent transfers under Minn. Stat. § 513.44(a)(1) were not "created by statute." Indeed, as described below, fraudulent transfer liability—both actual and constructive—existed for hundreds of years at common law prior to being recognized by Minnesota statute. Accordingly, the Receiver's claims are not liabilities "created by statute" under Minn. Stat. § 541.05, Subd. 1(2). Instead, they are claims for relief "on the ground of fraud," and Minn. Stat. § 541.05, Subd. 1(6), and its discovery rule, apply.

A. Fraudulent Transfer Liability Existed Under Common Law.

Far from being created by statute, fraudulent transfer liability has been part of American common law since the founding of this country. Originally part of Roman civil law, fraudulent transfer liability was first codified in England by the Statute of Elizabeth, 13 Eliz. c. 5 (1571). Like Minn. Stat. § 513.44(a)(1) today, the Statute of Elizabeth invalidated any transfers made by a debtor with the "intent to delay, hinder or defraud creditors."[4] After the American Revolution, the Statute of Elizabeth was incorporated into American common law, and many U.S. states enacted their own versions of the statute. *See* 24 Am Jur., *Fraudulent Conveyances*, § 3, at 163 (1st ed. 1939) ("[C]onveyances in fraud of creditors have, from the earliest times, been void at common law").

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[4] 13 Eliz. c. 5 (1571).

Two years after becoming a Territory of the United States, Minnesota enacted its own version of the Statute of Elizabeth. *See* Minn. Terr. Stat. ch. 64, § 1 (1851).[5] This statute, based on existing common law, remained part of Minnesota's statutes in substantially similar form for the next 162 years.[6] Based on this history, the Minnesota Supreme Court has long recognized that Minnesota's fraudulent transfer statutes are codifications of the common law. *See, e.g., Blackman v. Wheaton*, 13 Minn. 326, 330 (1868) ("The statute of 13 Eliz., c. 5, and the statute of our State rendering void certain conveyances made with fraudulent intent, are but declaratory of the common law."); *Piper v. Johnston*, 12 Minn. 60, 66 (1866) (stating that "13 Eliz. Ch. 5 … has been re-enacted in many of the States with little variation, and … is considered as only declaratory of the principles of common law.").

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5 *See* Minn. Terr. Stat. ch. 64, § 1 (1851) ("Every conveyance or assignment … of any estate or interest in lands, or goods in action … made with the intent to hinder, delay or defraud creditors or other persons … shall be void.").

6 *See id.* ("Every conveyance or assignment … of any estate or interest in lands, or goods in action … made with the intent to hinder, delay or defraud creditors or other persons … shall be void."); Minn. Gen. St. c. 51, § 1 (1858) ("Every conveyance or assignment … of any estate or interest in lands, or of goods, chattels, or things in action … made with the intent to hinder, delay or defraud creditors, or other persons … shall be void."); Minn. Gen. St. c. 41, § 18 (1863) ("Every conveyance or assignment … of any estate or interest in lands … made with the intent to hinder, delay or defraud creditors or other persons … shall be void."); Minn. Gen. St. c. 41, § 18 (1866) (same); Minn. Gen. St. c. 68, § 3498 (1905) (same); Minn. Gen. St. c. 68, § 7013 (1913) (same); Minn. Gen. St. c. 68, § 8481 (1922) ("Every conveyance made … with actual intent … to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors."); Minnesota Fraudulent Transfer Act, Minn. Stat. § 513.44(a)(1) (2013) (stating that transfers made "with actual intent to hinder, delay, or defraud" creditors are avoidable by present and future creditors of the debtor).

In 1863, the phrase "goods, chattels and things in action" was deleted from Minnesota's fraudulent transfer statute.[7] Nevertheless, at common law, fraudulent transfer liability continued to apply to both transfers of real and personal property. As stated by the Minnesota Supreme Court:

> The mere omission of a provision embracing "goods, chattels, and things in action" from a section of the statute declaring void conveyances and assignments of estates or interests in land, made with intent to hinder, delay, or defraud creditors, etc., will not be construed to be a repeal *of the common-law rule* which renders a conveyance of goods and chattels, made with such intent, fraudulent and void as to creditors, etc.

Blackman, 13 Minn. at 330 (emphasis added). *See Byrnes v. Volz*, 54 N.W. 942, 943 (Minn. 1893) (stating that Minnesota's fraudulent transfer statute "has been held merely declaratory of a rule of the common law, and, notwithstanding the omission of the words 'goods and chattels' in our enactment, the common-law rule, partially expressed therein, remains in force.").

Based on this common-law history of Minnesota's fraudulent transfer statutes, the Minnesota Supreme Court has repeatedly held that claims to recover fraudulent conveyances are not liabilities created by statute, but are claims for relief "on the ground of fraud," and that an action must be commenced within six years after the discovery of the fraud. *See Minneapolis Threshing,* 94 N.W. at 552; *Schmitt*, 93 N.W. at 111; *Brasie*,

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[7] *Compare* Minn. Gen. St. c. 51, § 1 (1858) ("Every conveyance or assignment ... of any estate or interest in lands, or of goods, chattels, or things in action ... made with the intent to hinder, delay or defraud creditors, or other persons ... shall be void"), *with* Minn. Gen. St. c. 41, § 18 (1863) ("Every conveyance or assignment ... of any estate or interest in lands ... made with the intent to hinder, delay or defraud creditors or other persons ... shall be void.").

92 N.W. at 342; *Duxbury*, 72 N.W. at 839; *McMillan*, 16 N.W. at 405 (holding that fraudulent conveyance actions are governed by Gen. St. 1894, § 5136, the statutory predecessor to Minn. Stat. § 541.05, Subd. 1(6)).

B. The Legislature Incorporated the Common Law in Enacting the Minnesota Uniform Fraudulent Conveyance Act and the Minnesota Uniform Fraudulent Transfer Act.

In 1918, the National Conference of Commissioners on State Laws promulgated the Uniform Fraudulent Conveyance Act ("UFCA"). In 1921, Minnesota adopted the UFCA in the form of the Minnesota Uniform Fraudulent Conveyance Act ("MUFCA"), which remained in effect for the next 66 years. *See* Minn. Laws c. 415, §§ 1–15, at 642–44 (1921). Like its predecessor statutes, Section 7 of the MUFCA provided that "[e]very conveyance made ... with actual intent ... to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." *See* Minn. Gen. St. c. 68, § 8481 (1922). As such, the UFCA and MUFCA were uniformly viewed as codifying existing law. "The scope of the [MUFCA] is to put into statutory form the Statute of Elizabeth relating to conveyances fraudulent as to creditors and the rules of construction which have developed around it." Bridgman, *Uniform Fraudulent Conveyance Act in Minnesota*, 7 Minn. L. Rev. 453, 455 (1922). *See also* Unif. Fraudulent Transfer Act 1984, Prefatory Note ("The [UFCA] was a codification of the 'better' decisions applying the Statute of 13 Elizabeth."); 24 Am Jur., *Fraudulent Conveyances*, § 5, at 165 (1^{st} ed. 1939) ("The [UFCA] is, in the main, declaratory of the rules which existed at the time of its adoption; it may be said to be a restatement of the statute of 13 Elizabeth.").

In 1984, the National Conference of Commissioners on State Laws promulgated the Uniform Fraudulent Transfer Act ("UFTA"), which was enacted in Minnesota in 1987 and remains in effect today. *See* Minn. Stat. §§ 513.41 to 513.51 (2013). As described in the UFTA's Prefatory Note, "[t]he basic structure and approach of the Uniform Fraudulent Conveyance Act are preserved in the Uniform Fraudulent Transfer Act." *See* Unif. Fraudulent Transfer Act 1984, Prefatory Note. Indeed, like Section 7 of the UFCA, Section 4(a)(1) of the UFTA provides:

> (a) A transfer made ... by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made ..., if the debtor made the transfer ...:
>
> > (1) with actual intent to hinder, delay, or defraud any creditor of the debtor;

UFTA, § 4(a)(1); Minn. Stat. § 513.44(a)(1).

As is apparent from the nearly identical statutory language, Section 4(a)(1) of the MUFTA was derived from Section 7 of the MUFCA. *See* Comment, Unif. Fraudulent Transfer Act 1984, § 4 (stating that "Section 4(a)(1) [of the UFTA] is derived from § 7 of the Uniform Fraudulent Conveyance Act."). Accordingly, because both Section 4(a)(1) of the MUFTA and Section 7 of the MUFCA codified existing common law, they are not "liabilit[ies] created by statute" under Minn. Stat. § 541.05, Subd. 1(2). Instead, they are claims for relief on the ground of fraud governed by Minn. Stat. § 541.05, Subd. 1(6).

II. THE RECEIVER'S CONSTRUCTIVE FRAUDULENT TRANSFER CLAIMS ARE ALSO GOVERNED BY MINN. STAT. § 541.05, SUBD. 1(6).

Count Three of the Receiver's complaint seeks to avoid transfers that First United and Johnston made: (1) while they were insolvent, and (2) without receiving reasonably equivalent value in exchange for the transfers. (A37–38) Under Minn. Stat. § 513.45(a):

> A transfer made ... by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made ... if the debtor made the transfer ... without receiving a reasonably equivalent value in exchange for the transfer ... and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer....

Minn. Stat. § 513.45(a) (2013).

This statute, like Minn. Stat. § 513.44(a)(1) described above, is wholly derived from common law. Under the Statute of Elizabeth and common law, "voluntary conveyances" (i.e., transfers made for little or no valuable consideration) by an insolvent debtor were voidable by the debtor's existing creditors. Significantly, this was true regardless of whether the debtor had actual intent to deceive his creditors in making the transfer.

Admittedly, prior to the enactment of MUFCA in 1921, Minnesota's fraudulent transfer statutes did not expressly provide for the avoidance of constructively fraudulent transfers. Nevertheless, avoidance of constructively fraudulent transfers by existing creditors has been part of the Minnesota common law since our earliest days as a state. As stated by the Minnesota Supreme Court in 1860:

> The general principle that a debtor cannot grant away his property to his family or a stranger by a voluntary conveyance, so as to interfere with the rights of his creditors,

> has been approved and adopted by all enlightened nations. It is so just in itself as to defy serious objection. It was declared in the civil law, and at a very early period established by the common law.

Filley v. Register, 4 Minn. 391, 396 (1860). As described in *Tupper v. Thompson*, Minnesota's pre-UFCA statutes required "intent to hinder, delay or defraud creditors" to avoid a fraudulent transfer. Nevertheless, the Court stated, a voluntary conveyance by an insolvent debtor necessarily prejudiced and delayed creditors, so the courts implied fraudulent intent as a matter of law:

> A voluntary transfer of personal property by an insolvent debtor by gift, or upon the consideration of a promised future support of the debtor, necessarily tends to prejudice and delay the just claims of his creditors, and is prima facie evidence of a fraudulent intent. The result in either case is to place the property beyond the reach of creditors, and in the latter to secure to the debtor the use and benefit of its avails. As against the creditors the law pronounces such a transaction fraudulent and void, and ineffectual to pass any title from the debtor.

Tupper v. Thompson, 4 N.W. 621, 622 (1880). Similarly, in *Underleak v. Scott*, the Court explained that voluntary transfers were presumptively fraudulent and, where the debtor was insolvent or failed to retain sufficient property to pay his creditors, fraudulent intent was *implied conclusively* from the circumstances surrounding the transfer:

> We are met at the outset by the finding of the trial court that there was no intent to hinder, delay, or defraud creditors.... The question of fraudulent intent is one of fact, unless the intent appears conclusively from the face of the instrument. A voluntary conveyance is presumptively fraudulent as to existing creditors, but it has long been settled in this state that it is not conclusively so. An intent by the grantor to hinder, delay, or defraud his creditors is a necessary element. The intent must exist at the time the transfer is made. *It 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.... The rule undoubtedly is that the debtor must retain sufficient property to amply satisfy his creditors.*

Underleak v. Scott, 134 N.W. 731, 733 (Minn. 1912) (emphasis added). *See also Thysell v. McDonald*, 159 N.W. 958, 959 (Minn. 1916) ("It is well settled that, where a debtor makes a conveyance without consideration and without retaining sufficient other property to pay his then existing debts, such conveyance may be set aside by his creditors...."); *Sovell v. Lincoln County*, 152 N.W. 727, 727–728 (Minn. 1915) ("[T[he voluntary conveyance ..., though valid between the parties, is presumptively fraudulent as to existing creditors of the grantor...."); *Woolley v. Cochran*, 112 N.W. 1143 (Minn. 1907) ("A strong case of fraud is not made out, but ... [t]he evidence ... justified the trial court in concluding that the conveyances in question were voluntary and without substantial consideration, and that the grantor was insolvent at the time of their execution."); *Henry v. Hinman*, 25 Minn. 199, 201 (1878) (stating that, a voluntary conveyance, "in the absence of proof of other property left to satisfy creditors, [is] a clear *prima-facie* case of an intent to defraud creditors"). *See also Hessian v. Patten*, 154 F. 829, 832 (8th Cir. 1907) ("A voluntary conveyance by an insolvent is fraudulent in itself, because it cannot be made without hindering and delaying his creditors."). At common law, therefore, where an insolvent debtor made a voluntary conveyance and failed to retain sufficient property to pay his creditors, fraudulent intent was found as a conclusion of law, and the transfer was avoidable.

In 1921, the common law of voluntary conveyances was incorporated into Section 4 of the MUFCA, dealing with constructive fraudulent transfers. *See* Minn. Laws c. 415, § 4 (1921); Minn. Gen. St. c. 68, § 8478 (1922). Because voluntary conveyances by insolvent debtors were already avoidable at common law, Section 4 of the MUFCA was a codification of existing law and did not create any new liability. "Section four [of MUFCA] states substantially the pre-existing law in Minnesota, as in the majority of states." Bridgman, *Uniform Fraudulent Conveyance Act in Minnesota*, 7 Minn. L. Rev. 530 (1923). Indeed, as aptly described by Professor Garrard Glenn in 1940:

> If the debtor is insolvent when he makes the gift, or the effect of it is to leave him insolvent, *there is a fraudulent conveyance as a matter of law.* The debtor's intent appears as a conclusion of law drawn from the facts as found.... *Such was the way of stating it before the Uniform Law came along, and its pragmatic language adds nothing to the score, except a different method of statement.*

1 G. Glenn, *Fraudulent Conveyances and Preferences*, at 460 (1940) (emphasis added).

In 1987, this common-law doctrine was again incorporated into Section 5 of the MUFTA, Minn. Stat. § 513.45(a). Under Minn. Stat. § 513.45(a), a transfer is avoidable by existing creditors "if the debtor made the transfer ... without receiving a reasonably equivalent value in exchange for the transfer ... and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer." Minn. Stat. § 513.45(a). Because this same liability existed at common law prior to the enactment of the MUFCA and MUFTA, *see Underleak*, 117 Minn. at 733; *Filley*, 4 Minn. at 405, it is not a liability "created by statute," and is instead governed by Minn. Stat. § 541.05, Subd. 1(6).

III. IN PONZI SCHEMES, ALL PAYMENTS IN FURTHERANCE OF THE SCHEME ARE MADE "WITH ACTUAL INTENT TO HINDER, DELAY, OR DEFRAUD" CREDITORS AS A MATTER OF LAW.

Under Minn. Stat. § 513.44(a)(1), transfers made "with actual intent to hinder, delay, or defraud any creditor of the debtor" are fraudulent and may be avoided by the debtor's present and future creditors. *See* Minn. Stat. § 513.44(a)(1) (2013). Where the debtor is running a Ponzi scheme, this fraudulent intent exists as a matter of law.

Ponzi schemes involve the payment of fictitious returns to existing investors from funds fraudulently obtained from new investors. Because a Ponzi scheme's promised returns are generated from new investors rather than legitimate business activity, Ponzi schemes are always insolvent from their inception. *See, e.g., Cunningham*, 265 U.S. at 8, 44, S. Ct. at 425 (stating that Charles Ponzi "was always insolvent, and became daily more so, the more his business succeeded."); *Janvey v. Democratic Senatorial Campaign Committee, Inc.*, 712 F.3d 185, 196 (5th Cir. 2013) (stating that "a Ponzi scheme is, as a matter of law, insolvent from its inception."). As a result, later investors in a Ponzi scheme necessarily lose their money when the scheme collapses.

Based on this fact, numerous courts have held that all transfers in furtherance of a Ponzi scheme are made "with actual intent to hinder, delay, or defraud" creditors as a matter of law:

> One can infer an 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. The investor pool is a limited resource and will eventually run dry. The perpetrator must know that the scheme will eventually collapse as a result of the inability to attract new investors. The perpetrator nevertheless makes

> payments to present investors, which, by definition, are meant to attract new investors. He must know all along, from the very nature of his activities, that investors at the end of the line will lose their money. Knowledge to a substantial certainty constitutes intent in the eyes of the law, and a debtor's knowledge that future investors will not be paid is sufficient to establish his actual intent to defraud them.

Merrill v. Abbott (In re Indep. Clearing House Co.), 77 B.R. 843, 860 (D. Utah 1987) (citations omitted). *See also Perkins v. Haines*, 661 F.3d 623, 626 (11th Cir. 2011); *Donell v. Kowell*, 533 F.3d 762, 770 (9th Cir. 2008); *In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 8 (S.D.N.Y. 2007); *In re Pearlman*, 472 B.R. 115, 123-24 (Bankr. M.D. Fla. 2012); *In re Polaroid Corp.*, 472 B.R. 22, 35 (Bankr. D. Minn. 2012); *In re Bayou Group LLC*, 439 B.R. 284, 305 (S.D.N.Y. 2010). In a Ponzi scheme, therefore, presumption of fraudulent intent is appropriate because transfers in furtherance of the scheme could be made for no other purpose than to "hinder, delay or defraud" creditors. *In re Bernard L. Madoff Investment Securities, LLC*, 458 B.R. 87, 105 (Bankr. S.D.N.Y. 2011) (citations omitted).

Finally, transfers are "in furtherance of the scheme" if the transfers were meant to preserve the scheme or attract new investors. *Manhattan Inv. Fund,* 397 B.R. at 13 (applying Ponzi scheme presumption to payments that "were essential to the continuation of the scheme"); *In re Vaughan Co., Realtors*, 500 B.R. 778, 790 (Bankr. D. N.M. 2013) ("For the Ponzi scheme presumption to apply, the transfers must have been made *in connection with* a Ponzi scheme."); *Polaroid*, 472 B.R. at 53 (applying presumption to transfers intended to "facilitate the preservation of the scheme, undetected by its current creditors and future investors"); *Bernard L. Madoff Investment Securities*, 458 B.R. at

105 (applying presumption to payments of fictitious profits and salaries because they "served to further the Ponzi scheme"); *In re World Vision Entm't, Inc.*, 275 B.R. 641, 656 (Bankr. M.D. Fla. 2002) ("Every payment made by the debtor to keep the scheme on-going was made with the actual intent to hinder, delay, or defraud creditors, primarily the new investors."). In particular, "payments received by investors as purported profits—i.e., funds transferred to the investor that exceed that investor's initial 'investment'—are deemed to be fraudulent transfers as a matter of law." *Johnson v. Neilson (In re Slatkin)*, 525 F.3d 805, 814 (9th Cir. 2008) (citing *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir. 1995) (describing payments of profits to investors as "theft by [the debtor] from other investors.")).

IV. THE COURT OF APPEALS ERRED IN NOT APPLYING THE PONZI SCHEME PRESUMPTION TO THE TRANSFERS MADE TO ALLIANCE BANK.

Once the plaintiff makes out a *prima facie* case for avoidance of a fraudulent transfer under Minn. Stat. § 513.44(a)(1), the presumption of fraudulent intent may be rebutted if the defendant produces evidence of a legitimate purpose for the transfer. *See Kelly v. Armstrong*, 141 F.3d 799, 802 (8th Cir. 1998); *Polaroid*, 472 B.R. at 60, 67–69. In such circumstances, the burden of production shifts to the defendant to provide direct evidence of a "legitimate supervening purpose" for the transfer. *Polaroid*, 472 B.R. at 35 (citing *Kelly*, 141 F.3d at 799, 801). Fraudulent intent can "be rebutted by hard proof of contrary intent, i.e., a credible motivation to make the transfer that is grounded in good economic reason as to the transferor-entity." *Id.* at 42. In such circumstances, "the burden is on the defendant to show that the fraud was harmless because the debtor's assets were not depleted even slightly." *Scholes*, 56 F.3d at 757.

Here, the Court of Appeals erred by holding that the transfers to Alliance Bank were made for a legitimate purpose.

A. Alliance Did Not Meet Its Burden To Show That the Transfers Were Legitimate.

In concluding that the payments to Alliance were not fraudulent, the Court of Appeals stated that "[t]he payments to Alliance were not fictitious profits that depleted First United's resources ..., but rather were profits that First United paid out in exchange for reasonably equivalent value." *Finn v. Alliance Bank*, 838 N.W.2d 585, 602 (Minn. Ct. App. 2013). In reaching this conclusion, however, the Court inappropriately placed the burden on the Receiver, as illustrated below:

- "The receiver does not assert that Alliance's participation was in an oversold or fraudulent loan." *Finn*, 838 N.W.2d at 601.
- "Moreover, the receiver did not allege ... that ... payments to Alliance depleted First United's assets ...." *Id.* at 602.
- "Further, the receiver does not assert that Alliance lacked good faith when it entered into the loan-participation agreement with First United." *Id.*

Under the Ponzi scheme presumption, once the Receiver showed that the transfers were made in furtherance of the scheme, Alliance should have been required to show by direct and substantial evidence that value was given, and that First United had a good economic reason for paying Alliance besides keeping the Ponzi scheme alive. By improperly placing the burden on the Receiver to disprove these facts, the Court of Appeals erred as a matter of law.

Further, the record below shows that: (1) at all times when Alliance received payments from First United, First United was insolvent (*see* March 19, 2012 Aff. of Patrick Finn, ¶ 17, A138), and (2) First United's payments of profit to Alliance were made with commingled funds that were stolen from other investors. (*Id.*, ¶¶ 23-24, A139-A140) In light of this record, it is apparent that First United's payments to Alliance were made with stolen funds that were used to further the Ponzi scheme. As a result, application of the Ponzi scheme presumption to these payments is appropriate, and the Court of Appeals erred by allowing Alliance to rebut the presumption.

Finally, the fact that First United may have had some "legitimate business" as part of its Ponzi scheme does not alter the payments' status as a fraudulent transfer. As recognized by numerous courts, the fact that a Ponzi scheme may have some revenue-generating business will not defeat a finding of fraudulent intent where the legitimate business could not reasonably be expected to fund the debtor's operations. Indeed, "[m]any Ponzi schemes, if not most, have some legitimate business operation...." *In re Bonham*, 251 B.R. 113, 131 (Bankr. D. Alaska 2000). "[A Ponzi] scheme is always founded upon some legitimate business enterprise.... Investors are encouraged to invest or lenders to loan based upon the appearance of a profitable legitimate business." *In re LLS America, LLC*, No. 09-06194-PCW11, 2013 WL 3305393, at *6, 9 (Bankr. E.D. Wash. July 1, 2013). *See also Scholes*, 56 F.3d at 750 (some legitimate trading of commodities); *In re Manhattan Inv. Fund Ltd.*, 397 B.R. at 4 (some legitimate business selling technology stocks); *Wiand v. Morgan*, 919 F. Supp. 2d 1342, 1364 (M.D. Fla. 2013) (some legitimate trading business); *Polaroid*, 472 B.R. at 31 ("[t]he past operation of a free standing business by a 'legitimate' business entity … does not bar the application of the rule.").

Here, because the evidence showed: (1) that First United was running a Ponzi scheme, (2) that First United was insolvent when it made payments to Alliance, and (3) that Alliance's payments were made with commingled funds that were stolen from other investors, the Court of Appeals erred in rejecting the Ponzi scheme presumption.

B. Alliance Did Not Give Reasonably Equivalent Value In Exchange for Profits.

In Ponzi schemes, the general rule is that an investor gives "value" to the debtor in exchange for a return of the principal amount of its investment, but not as to any payments in excess of the principal. Normally, one who has been induced to enter a contract by fraudulent misrepresentations may elect to either rescind the contract and seek restitution, or affirm the contract and sue for damages. *See, e.g., Anders v. Dakota Land and Dev. Co., Inc.*, 289 N.W.2d 161, 163 (Minn. 1980). In Ponzi schemes, however, as a matter of public policy, investors' contracts in a Ponzi scheme are unenforceable to the extent they seek payments in excess of their principal investment:

> To allow an investor to enforce his contract to recover promised returns in excess of his investment would be to further the debtors' fraudulent scheme at the expense of other investors. Any recovery would not come from the debtors' own assets because they had no assets they could legitimately call their own. Rather, any award of damages would have to be paid out of money rightfully belonging to other victims of the Ponzi scheme.

In re Hedged-Invs. Assocs., Inc., 84 F.3d 1286, 1290 (10th Cir. 1996) (quoting *In re Indep. Clearing House Co.*, 77 B.R. at 858). For this reason, courts have recognized that defrauded investors are tort creditors who possess only a claim for fraud or restitution against the debtor arising at the time of their initial investment. *Perkins*, 661 F.3d at 627; *In re AFI Holding, Inc.*, 525 F.3d 700, 708 (9th Cir. 2008); *In re Hedged-Invs. Assocs.*, 84 F.3d at 1289-90. As a result, any transfer up to the amount of the principal investment satisfies the investors' fraud claim and is made for "value" in the form of the investor's surrender of his or her tort claim. *Id.* Such payments are not subject to recovery as a fraudulent transfer. Any transfers over and above this amount—i.e., for fictitious profits—are not made for "value" because they exceed the scope of the investors' fraud claim and are comprised of other victims' money. *See, e.g., Perkins*, 661 F.3d at 627; *Donell*, 533 F.3d at 770; *AFI Holding*, 525 F.3d at 708-09; *Scholes*, 56 F.3d at 757-58; *Bernard L. Madoff Investment Securities*, 458 B.R. at 112; *In re Ramirez Rodriguez*, 209 B.R. 424, 434 (Bankr. S.D. Tex. 1997); *In re Randy*, 189 B.R. 425, 440–41 (Bankr. N.D. Ill. 1995); *In re Taubman*, 160 B.R. 964, 985 (Bankr. S.D. Ohio 1993). These transfers are not made for value, and as a result, they may be avoided as a fraudulent transfer.

Here, Alliance's participation agreement is unenforceable to the extent Alliance seeks payment in excess of its principal investment. Because the record shows that Alliance received payments over and above this amount, the Court of Appeals erred in concluding that Alliance gave reasonably equivalent value in exchange for these transfers.

CONCLUSION

Based on the common-law history of Minnesota's fraudulent transfer statutes, the Court of Appeals was correct that claims to recover fraudulent transfers under Minn. Stat. § 513.44(a)(1) are claims for relief "on the ground of fraud," and the discovery rule applies under Minn. Stat. § 541.05, Subd. 1(6).

In addition, at common law, where an insolvent debtor voluntarily conveyed its assets without receiving reasonably equivalent value, the debtor's fraudulent intent was implied as a matter of law and the transfer was avoidable. Therefore, the Court of Appeals erred in holding that constructive-fraud claims are liabilities "created by statute" under Minn. Stat. § 541.05, Subd. 1(2). Like the Receiver's actual fraud claims, these claims are claims for relief "on the ground of fraud" governed by Minn. Stat. § 541.05, Subd. 1(6).

Finally, because the evidence shows: (1) that First United was running a Ponzi scheme, (2) that First United was insolvent when it made payments to Alliance, and (3) that First United's payments to Alliance were made with commingled funds stolen from other investors, the Court of Appeals erred in not applying the Ponzi scheme presumption to the transfers made to Alliance in this case. The Court of Appeals also erred in concluding that Alliance gave reasonably equivalent value in exchange for profits it received from the scheme, over and above its principal investment. As a matter of law, these transfers were not made for value, and as a result, they may be avoided as a fraudulent transfer.

Based on the above, the Trustee and the Unsecured Creditors' Committee respectfully request that the Court of Appeals' decision be affirmed in part and reversed in part.

Dated: December 26, 2013

KELLEY, WOLTER & SCOTT, P.A.

By: Steven E. Wolter

Steven E. Wolter (#170707)
Centre Village Offices
431 South Seventh Street, Suite 2530
Minneapolis, Minnesota 55415
Telephone: (612) 371-9090
Facsimile: (612) 371-0574

ATTORNEYS FOR AMICUS CURIAE DOUGLAS A. KELLEY, AS CHAPTER 11 TRUSTEE OF PETTERS COMPANY, INC., ET AL.

Dated: December 26, 2013

FAFINSKI MARK & JOHNSON, P.A.

By:

David E. Runck (#0289954)
Connie A. Lahn (#0269219)
400 Flagship Corporate Center
775 Prairie Center Drive
Eden Prairie, Minnesota 55344
Telephone: (952) 995-9500
Facsimile: (952) 995-9577

ATTORNEYS FOR AMICUS CURIAE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF PETTERS COMPANY, INC., ET AL.

CERTIFICATION OF BRIEF LENGTH

I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01, subds. 1 and 3, for a brief produced with a proportional font. The length of this brief is 6,380 words. This brief was prepared using Microsoft Word version 2010.

Dated: December 26, 2013

FAFINSKI MARK & JOHNSON, P.A.

By:__________________________
David E. Runck (#0289954)
400 Flagship Corporate Center
775 Prairie Center Drive
Eden Prairie, Minnesota 55344
Telephone: (952) 995-9500

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APPELLATE COURTS

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County of Hennepin)

Affidavit

Stephen M. West, being first duly sworn, states that he is an employee of Bachman Legal Printing, located at 733 Marquette Avenue, Suite 109, Minneapolis, MN 55402. That on **December 26, 2013**, he prepared the **Brief of Amici Curiae Douglas A. Kelley, as Chapter 11 Trustee and the Official Committee of Unsecured Creditors of Petters Company, Inc. and Petters Group Worldwide, LLC**, case numbers **A12-1930 and A12-2092**, and served **2** copies of same upon the following attorney(s) or responsible person(s) by **First Class Mail postage prepaid.**

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December 26, 2013

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NOTARY PUBLIC-MINNESOTA
My Commission Expires Jan. 31, 2015

Notary Public Barry McDonald

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733 Marquette Avenue
Suite 109
Minneapolis, MN 55402

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Patrick Finn, et al. v. Alliance Bank, et al.
Supreme Court File Nos. A12-1930 and A12-2092

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

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

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

Christopher R. Morris (#230613)
Michelle Kreidler Dove (#33232X)
BASSFORD REMELE, P.A.
33 South Sixth Street, Suite 3800
Minneapolis, MN 55402
(612) 333-3000

Attorneys for Respondent 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 Respondent Home Federal Bank

Shari L. J. Aberle (#0306551)
Erin Collins (#0388967)
Andrew B. Brantingham (#0389952)
DORSEY & WHITNEY LLP
50 South Sixth Street, Suite 1500
Minneapolis, MN 55402-1498
(612) 340-2600

Attorneys for Respondent KleinBank

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

Attorneys for Respondent Merchant's Bank

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

Attorneys for Respondent M&I Marshall & Ilsley Bank

Thomas H. Boyd (#200517)
Michael A. Rosow (#0317998)
WINTHROP & WEINSTINE, P.A.
225 South Sixth Street, Suite 3500
Minneapolis, MN 55402
(612) 604-6400

Attorneys for Amicus Curiae DZ Bank AG, Deutsche Zentral Genossenschaftsbank, Frankfurt Am Main

H. Peter Haveles, Jr.
KAYE SCHOLER LLP
425 Park Avenue
New York, New York 10022-3598
(212) 836-7604

Attorneys for Amicus Curiae DZ Bank AG, Deutsche Zentral Genossenschaftsbank, Frankfurt Am Main

James P. Conway, (#0391044)
JASPERS, MORIARTY & WALBURG, P.A.
206 Scott Street
Shakopee, MN 55379
(952) 445-2817

Attorneys for Amicus Curiae Epsilon/Westford

Daniel E. Reidy
Theodore T. Chung
Tara A. Fumerton
JONES DAY
77 West Wacker
Chicago, IL 60601
(312) 782-3939

Attorneys for Amicus Curiae Epsilon/Westford

David C. Kiernan
Brian D. McDonald
JONES DAY
555 California Street, 26th Floor
San Francisco, CA 94101
(415) 626-3939

Attorneys for Amicus Curiae Epsilon/Westford

Joseph G. Petrosinelli
Jonathan M. Landy
Christopher J. Mandernach (#0389089)
WILLIAMS & CONNOLLY LLP
725 Twelfth Street, N.W.
Washington D.C. 20005
(202) 434-5000

Attorneys for Amicus Curiae Opportunity Finance, LLC.

Bruce J. Douglas (#023966)
OGLETREE, DEAKINGS, NASH, SMOAK & STEWART, P.C.
Wells Fargo Center
90 South Seventh Street, Suite 3800
Minneapolis, MN 55402
(612) 336-6858

Attorneys for Amicus Curiae JPMorgan Chase Bank, N.A.

David Woll
Isaac Rethy
SIMPSON THACHER & BARTLETT LLP
425 Lexington Avenue
New York, NY 10017-3954
(212) 455 3136

Attorneys for Amicus Curiae JPMorgan Chase Bank, N.A.

Michael Freedman
SIMPSON THACHER & BARTLETT LLP
1999 Avenue of the Stars- 29th floor
Los Angeles, CA 90067
(310) 407-7530

Attorneys for Amicus Curiae JPMorgan Chase Bank, N.A.

Frederick H. Miller (#392030)
Craig P. Miller (#26961X)
GRAY PLANT MOOTY & BENNETT, P.A.
500 IDS Center
80 South Eighth Street
Minneapolis, MN 55402

Attorneys for Amicus Curiae The Clearing House Association L.L.C.

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
(612) 338-5815

Attorneys for Amicus Curiae Highland Bank and Voyager Bank

Bruce Jones (#179553)
FAEGRE BAKER DANIELS LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 766-7000

Attorneys for Amicus Curiae Minnesota Defense Lawyers Association

Karen E. Wagner
Andrew S. Gehring
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
(212) 450-4000

Attorneys for Amicus Curiae The Clearing House Association L.L.C.

Kevin D. Hofman (#179978)
HALLELAND HABICHT P.A.
33 South Sixth Street 3900
Minneapolis, MN 55402
(612) 836-5500

Attorneys for Amicus Curiae City National Bank