Nos. A12-1930 and A12-2092

State of Minnesota

In Supreme Court

OFFICE OF
APPELLATE COURTS

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FILED

Patrick Finn and Lighthouse Management Group, Inc.,
Appellants/Cross-Respondents,

v.

Alliance Bank,
Respondent,

Home Federal Bank,
Respondent / Cross-Appellant,

Klein Bank,
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.

RESPONDENT ALLIANCE BANK'S BRIEF AND APPENDIX

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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STATEMENT OF ISSUES

I. Did the Court of Appeals correctly hold that under the facts of this case, the "Ponzi-scheme presumption" does not preclude a finding that Alliance Bank received interest payments in good faith and for reasonably equivalent value?

A unanimous Court of Appeals panel reversed the grant of summary judgment to Petitioners Patrick Finn and Lighthouse Management Group, Inc. and held that a Ponzi-scheme presumption could not be fully applied under the circumstances to transform loan payments to Alliance Bank into fraudulent transfers. The panel stated that based on the unique facts of this case, the plain language of the Minnesota Fraudulent Transfer Act, and existing Minnesota precedent, it was error to "presume" as a matter of law that the interest payments received by Alliance could not possibly be funds received in good faith in exchange for reasonably equivalent value, which are not considered fraudulent transfers.

Apposite Authorities:

Minn. Stat. § 513.44 *et seq.*;

Neubauer v. Cloutier, 265 Minn. 539, 122 N.W.2d 623 (1963);

Skinner v. Overend, 190 Minn. 456, 252 N.W. 418 (1934);

Kummet v. Thielen, 210 Minn. 302, 298 N.W. 245 (Minn. 1941).

II. Alternatively, did the district court err in holding in the context of summary judgment that the Receiver is entitled to recover from Alliance interest payments immediately transferred by Alliance to a subparticipant bank and interest payments received by Alliance more than six years before this lawsuit was commenced?

This issue was not addressed by the Court of Appeals, because it was unnecessary given its ruling that Alliance was entitled to judgment as a matter of law.

Apposite Authorities:

Minn. Stat. § 513.44 *et seq.*;

Riederer v. Northern Capital, Inc. (In re Brooke Corp.), 458 B.R. 579 (Bankr. D. Kan. 2011);

Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890 (7th Cir. 1988).

STATEMENT OF CASE

This appeal involves the interpretation of the Minnesota Uniform Fraudulent Transfer Act (MUFTA) and the application of the "Ponzi-scheme presumption" as adopted by a number of federal courts. Appellants are Patrick Finn and Lighthouse Management Group, Inc. (Receiver), receivers for First United Funding, LLC (FUF), who seek to "claw back" certain loan payments received by Alliance and other banks for the purpose of re-distributing those funds to other banks that funded fictitious loans through FUF that were not repaid. Respondent is Alliance Bank (Alliance), a Minnesota family owned community bank.

The Receiver commenced this action in May 2011, seeking to "claw back" interest payments made to Alliance from 2002-2007 in payment of a loan that Alliance purchased from FUF. The Receiver alleged claims under the MUFTA and unjust enrichment. In response to initial Rule 12 motions of Alliance and other banks seeking a determination on the pleadings, the district court dismissed the unjust enrichment count, dismissed all claims against several banks in light of the six-year statute of limitations, and held that Alliance was not liable for payments received more than six years prior to commencement of the action.

The Receiver and Alliance later filed cross-motions for summary judgment. The Receiver requested that all interest payments received by Alliance on the underlying loan be returned, on the ground that FUF operated a Ponzi scheme and therefore every element of the MUFTA is automatically presumed satisfied without exception or rebuttal. The district court granted the Receiver's motion in its entirety and entered judgment

against Alliance in the full amount requested, $1,235,388. Despite its earlier ruling that the six year statute of limitations barred some of the interest payments to Alliance, the district court held Alliance was liable for all interest payments received under the loan. In its summary judgment order, the district court did not address Alliance's defense that it was a mere conduit for two-thirds of the interest payments, which were transferred to a sub-participant bank as the final transferee.

The Court of Appeals reversed and directed that judgment be entered in favor of Alliance, unanimously holding that the application of the Ponzi-scheme presumption to the claims against Alliance was an improper extension of Minnesota law. Specifically, the Court of Appeals panel concluded that the justification for applying the presumption to conclude that payments made in furtherance of a Ponzi scheme could never be received in good faith in exchange for reasonably equivalent value did not apply to the claims against Alliance. The Court of Appeals further determined that it did not need to reach a decision on whether to fully adopt the Ponzi-scheme presumption in this case because the payments to Alliance weren't avoidable under well-established Minnesota law even in light of the Ponzi-scheme presumption.

The issues on which the Receiver sought and was granted review by this Court concern the appropriate statute of limitations (an issue briefed separately by other bank respondents) and applicability of the "Ponzi-scheme presumption" to fraudulent-transfer actions brought under MUFTA (which is the focus of Alliance's brief).

STATEMENT OF FACTS

Alliance Purchases a Loan to Jerry Moyes.

In 2002, Alliance Bank (a family owned community bank, then known as American Bank Lake City) purchased a 100% participation in a real (not fictitious or over-sold) loan made to a well-established business man in Arizona (and former owner of the Phoenix Coyotes NHL team), Jerry Moyes. (R.App.002-03.) The funds provided by Alliance went to Mr. Moyes and were used for his legitimate business purposes, and Mr. Moyes fully repaid the loan. (R.App.003; R.App.010.) Alliance purchased the loan from FUF, a loan broker, whose principal was Corey Johnston. (R.App.008; R.App.002.) At that time, it was a common practice for loan brokers to approach banks with potential loan deals to third parties. (R.App.002.) FUF provided Alliance with copies of the loan documents including the promissory note and loan agreement as required by the participation agreement. (R.App.008.)

The loan was for $3,180,000 to provide temporary financing for three trucking terminals, used by companies in which Mr. Moyes' held an interest (Swift Transportation and Central Transport), until he could obtain permanent financing for the terminals. (R.App.008; R.App.002.) Documents provided to Alliance indicated that the loan was more than fully secured by the family trust account of Jerry Moyes and his wife Vickie Moyes. (R.App.002.)

For reasons relating to Jerry Moyes's businesses, permanent financing for the terminals was delayed. (*Id.*) The loan, which had an initial term of one year, was thus extended several times. (*Id.*) In connection both with the initial placement and with each

renewal, Alliance conducted due diligence on the loan. (R.App.002-03.) This included reviewing Mr. Moyes's tax returns and income statements as well as the trust account statements. (R.App.002.) An attorney for Alliance, Brian Leonard, reviewed the Moyes trust to ensure it could be properly pledged as collateral. (*Id.*) Moreover, Alliance monitored news reports relating to Jerry Moyes and his business interests, and Corey Johnston kept Alliance informed of the happenings in those businesses as well as the status of obtaining permanent financing for the terminals. (R.App.003-06.) Alliance made the decision to purchase the loan based on Jerry Moyes's financial credentials and the substantial collateral provided as security for the loan. (R.App.003.)

After purchasing the Moyes loan, Alliance sold a $2 million portion of the loan to an unrelated bank, Security National Bank of Durand, Wisconsin ("Security").[1] (R.App.010.) The interest rate paid to Alliance on the loan ranged from 6.5% to 10.75%. (*Id.*) Alliance kept a half-point spread on its sub-participation with Security, and FUF kept a quarter-point spread. (*Id.*) These rates were generally consistent with what Alliance was receiving on similar loans during that time period. (*Id.*) Pursuant to the participation agreements, Alliance passed on a proportionate share of each payment to the sub-participants, including approximately 63% to Security. (*See id.*) Alliance served as a conduit for those interest payments, forwarding them by wire transfer on the same day they were received from FUF. (*Id.*)

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[1] Alliance also sold a much smaller portion of the loan to an affiliated bank which was later merged into Alliance. (R.App.010.)

Alliance's internal loan accounting reflects the following breakdown of payments with respect to the Moyes loan:

PAYMENTS MADE ON OR BEFORE MAY 11, 2005		
Value of Participation Interest	Principal payments	Interest Payments
American Bank Lake City n/k/a Alliance Bank $1,000,000.00		$192,208.19
Alliance affiliate $180,000.00		$31,422.50
Security National Bank $2,000,000.00		$337,263.89
Total $3,180,000.00		**$560,894.58**

PAYMENTS MADE AFTER MAY 11, 2005		
Value of Participation Interest	Principal payments	Interest Payments
American Bank Lake City n/k/a Alliance Bank $1,000,000.00	$1,000,000.00	$239,362.20
Alliance affiliate $180,000.00	$180,000.00	$9,545.12
Security National Bank $2,000,000.00	$2,000,000.00	$368,901.87
Total $3,180,000.00	**$3,180,000.00**	**$617,809.19**

(R.App.011.)

The Participation Agreement with FUF.

The Participation Agreement with FUF provided that Alliance became the legal owner of the loan. (*See* R.App.008.) The agreement defined the relationship between the parties as that of buyer and seller of a property interest, and provided that FUF was named only as the "nominal" payee on the note and held any interest in the note or other loan documents only as agent for Alliance and not in its individual capacity:

> 2.2. Relationship to Parties. The relationship between Lender and Participant is and shall be that of a seller and purchaser of a property interest (i.e., an outright, absolute partial assignment of an undivided interest in and to the Loan, in the Collateral and in the Collections) and not a creditor-debtor relationship. Participant hereby approves of and authorizes Lender to be named as the nominal payee of the Note and nominal beneficiary of each Guaranty and the nominal secured party under the Loan Documents, and, subject to the provisions of this Agreement, to generally act as agent for all Participants in the holding and disposition of the Collateral. Lender agrees that Lender holds the security interests and other interests granted by the Note and the Loan Documents not in its individual capacity but rather as agent for Participants in accordance with this Agreement.

(R.App.019.) The agreement further provided that FUF would act as servicer of the loan. (R.App.023.) Under the terms of the agreement, Alliance's participation percentage was 100%. (R.App.035.) Thus, Alliance purchased a 100% undivided interest in the loan itself and all of the proceeds. (*See id.*)

Payments on the Moyes Loan.

The Receiver does not assert that Alliance's participation was in an oversold or fraudulent loan. (Add28.) Alliance received regular interest payments on the Moyes loan and immediately forwarded a proportionate share of these interest payments to Security. (R.App.010.) The initial loan agreement required monthly payments of interest, with the principal due at maturity, as did the first two renewals. (R.App.047-49; R.App.051-54.) The last two terms of the loan required five-percent and ten-percent principal pay-downs, which were received by Alliance (R.App.060-61; R.App.067-68), and Alliance sent on a proportionate share to Security. (R.App.010.) The remaining principal was paid in 2007 (in conjunction with Jerry Moyes's purchase of Swift

Transportation). (*Id.*) It is undisputed that that Mr. Moyes paid FUF the full amount of the loan principal, plus fees and interest, and that FUF in turn paid Alliance the amount required under the loan-participation agreement. (Add28.)

To Alliance, it appeared all payments originated with Mr. Moyes. (*See* R.App.003.) Although the Receiver points to a few occasions where there was a difference in the timing of when Mr. Moyes paid FUF and when Alliance received the funds from FUF, such discrepancies do not change the fact that Mr. Moyes paid the loan in full to FUF and FUF paid Alliance. (*See* R.App.010; R.App.105-06.) Further, the Receiver's own records demonstrate that the money Alliance paid to acquire the loan was in fact sent to Mr. Moyes, that FUF received the payoff amount in connection with the purchase of Swift Transportation and sent that amount to Alliance, and that Mr. Moyes made loan payments throughout the time Alliance was receiving payments from FUF. (R.App.107; R.App.126-30.) Upon receiving the final payment, Alliance released its interest in the collateral. (R.App.011.)

Throughout the life of the loan, there were never any apparent irregularities with Corey Johnston, FUF, or Mr. Moyes. (R.App.003.) In fact, the Receiver admitted that he does not have any facts demonstrating any lack of good faith on the part of Alliance in purchasing the loan or demonstrating that Alliance knowingly participated in the alleged Ponzi scheme. (R.App.102-04.) In addition, it is undisputed that the Moyes loan owned by Alliance was not oversold by FUF (although the district court stated as a fact finding that FUF did sell participations that exceeded loan amounts, perhaps in reference to loans other than the single loan at issue). (*Compare* R.App.107 *with* Add36.)

Alliance obviously had considerable overhead expenses, such as employee salaries and office space costs, during all relevant time periods. (R.App.012.) These costs were paid in part by interest received and retained on the Moyes and other loans. (*Id.*) As noted above, most of the interest paid on the Moyes loan was immediately wired to Alliance's sub-participant, and thus was never owned or retained in the first place. (R.App.010.)

Corey Johnston pleads guilty to bank fraud and filing false tax returns.

In August 2010, Corey Johnston was charged with bank fraud and filing false tax returns. (A1.) The Amended Information detailed that Corey Johnston had defrauded banks by overselling loan participations in certain loans and falsified his tax returns by understating his income. (A42-48.) Mr. Johnston pled guilty to both counts and admitted that from some time in approximately 2005 to 2009 he had deliberately defrauded banks by overselling participations. (A53.) He was sentenced to six years in prison. (A1.)

Despite the fact that Johnston pled guilty to overselling participations in certain loans, the Receiver admitted that he has no evidence that the single Moyes loan purchased by Alliance was oversold or in any other way fictitious. (R.App.107.) Notably, the Moyes loan was purchased by Alliance years before Johnston's admitted criminal activity. (*Compare* R.App.008 *with* A53.)

SUMMARY OF THE ARGUMENT

As the Court of Appeals held, the routine loan payments received by Alliance are not "fraudulent transfers" under established Minnesota law. The facts of this case (as distinguished from the various federal cases which the Receiver cites as precedent, such as *Petters*), do not warrant the adoption of a "Ponzi-scheme presumption" to modify well-established Minnesota law, rather than leaving such policy decisions to the legislature. The Court of Appeals expressly declined to determine whether the Ponzi-scheme presumption can ever be applied to claims asserted under the MUFTA. Instead, it limited its holding to the facts of the case, and concluded in a well-reasoned and unanimous opinion that the presumption should not fully apply to the claims against Alliance.

The loan payments to Alliance were made pursuant to a legitimate transaction that involved an actual lender and an actual borrower with assets. Alliance conducted due diligence at the origination of the loan, and proceeded in good faith. The loan documents provided a commercially-reasonable interest rate. Alliance provided its own money that was used by businessman Jerry Moyes for a legitimate purpose – to operate his business. Mr. Moyes made timely payments under the loan, and eventually paid back the full loan amount plus interest, according to the terms of the loan agreement. Alliance, acting as a conduit, forwarded roughly two-thirds of the payments to a sub-participant bank. Upon Mr. Moyes's satisfaction of his loan obligations, Alliance completed its payment obligations to the sub-participant bank and released its interest in the collateral.

The Court of Appeals recognized that under these facts, and unlike the cases most heavily relied upon by the Receiver[2], the interest payments to Alliance were not fictitious profits that depleted FUF's resources to the detriment of other creditors (*i.e.*, banks who more recently purchased fictitious loans). *Finn v. Alliance Bank*, 838 N.W.2d 585, 602 (Minn. App. 2013). FUF received benefits from Alliance's purchase of the Moyes loan, rather than a depletion of resources. *See id.* Moreover, had Alliance not received timely re-payment of the loan, it could have recovered payments directly from Mr. Moyes, who had sufficient assets to re-pay the loan to FUF, plus required interest and fees. *See id.* Banks which later purchased fictitious loans are not similarly positioned. Had other banks purchased real loans, they also could have pursued the borrower for re-payment.

Under these circumstances, the justification cited by federal courts for the Ponzi-scheme presumption does not apply. *Id.* at 601-02. The result urged by the Receiver would change existing statutory requirements of proof, which is a task for the legislature. If this Court accepts the Receiver's invitation to create presumptions under MUFTA to include banks receiving ordinary interest in good faith, on legitimate loans funded by the bank, what logic would prevent further expansion of the judicially created doctrine? Why not recoup profits earned by vendors on payments received from a schemer for office rent or supplies? The MUFTA was simply not designed to recoup all payments that might have involved funds co-mingled with ill-gotten gains.

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[2] In classic Ponzi schemes in which the Ponzi scheme presumption has been used to re-distribute "investment profits," there is no Mr. Moyes. He is invented by the schemer. Instead of collecting legitimate loan payments, the schemer simply uses money from new participants, attracted by a deal too-good-to-be-true, to make payments to other investors.

STANDARD OF REVIEW

On appeal from summary judgment, this Court determines whether genuine issues of material fact exist and whether the district court correctly applied the law. Minn. R. Civ. P. 56.03; *White v. City of Elk River*, 840 N.W.2d 43, 48 (Minn. 2013). The Court applies a de novo standard of review to the district court's application of the law. *White*, 840 N.W.2d at 48; *Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co.*, 819 N.W.2d 602, 610 (Minn. 2012). The Court must take a view of the evidence most favorable to the one against whom the motion was granted. *Offerdahl v. Univ. of Minn. Hosp. & Clinics*, 426 N.W.2d 425, 427 (Minn. 1988).

STATEMENT OF THE ARGUMENT

I. THE COURT OF APPEALS CORRECTLY DECIDED THAT THE APPLICATION OF A PONZI-SCHEME PRESUMPTION TO DECIDE THE ISSUE OF WHETHER INTEREST WAS RECEIVED BY ALLIANCE IN GOOD FAITH AND FOR REASONABLY EQUIVALENT VALUE DOES NOT MAKE SENSE AND IS AN IMPROPER EXTENSION OF THE MINNESOTA FRAUDULENT TRANSFER ACT.

A. The Minnesota Fraudulent Transfer Act.

The MUFTA, Minnesota Statutes section 513.44 *et seq.*, and its predecessor, the fraudulent-conveyance statute, were enacted to give creditors a direct remedy against a debtor who secretes away assets to hinder, delay and defraud its creditors. *See In re Butler*, 552 N.W.2d 226, 232 (Minn. 1996); *Lind v. O.N. Johnson Co.*, 204 Minn. 30, 41, 282 N.W. 661, 668 (1938). Specifically, transfers are subject to avoidance if the debtor made them "with actual intent to hinder, delay, or defraud any creditor of the debtor," or "without receiving a reasonable equivalent value in exchange for the transfer or obligation." Minn. Stat. § 513.44(a) (2012); *see also* Minn. Stat. § 513.45(a) (2012)

(specifically addressing fraudulent transfers to present creditors); *Snyder Elec. Co. v. Fleming*, 305 N.W.2d 863, 867 (Minn. 1981) (discussing general scope of the MUFTA). Even if fraudulent intent on the part of the debtor transferor is proven, the transferee still is not liable if it acted in good faith and accepted a reasonably equivalent value. Minn. Stat. § 513.48(a) (2012).

In this case, Alliance submitted undisputed evidence of its good faith, and in fact, the Receiver concedes that the Moyes loan was legitimate. *See Finn*, 838 N.W.2d at 602. In addition, Alliance provided reasonably equivalent value pursuant to a legitimate loan agreement. Thus, the transfers cannot be avoided under Minnesota law.

The MUFTA is modeled after the Uniform Fraudulent Transfer Act. *Butler*, 552 N.W.2d. at 231. The Uniform Act stems from the Statute of 13 Elizabeth which was enacted to invalidate "covinous and fraudulent transfers designed to delay, hinder, or defraud creditors and others." *Id.* (quotations omitted). The purpose of the MUFTA is simply to prevent debtors from putting property that is available for payment of their debts beyond the reach of their creditors. *Kummet v. Thielen*, 210 Minn. 302, 306, 298 N.W. 245, 247 (1941). It was never intended to reallocate losses sustained by multiple competing creditors who had the misfortune to do business with a fraudster.

In fact, the MUFTA has never been interpreted by Minnesota courts to remedy preferential payments among competing creditors. To the contrary, it has been specifically held <u>not</u> to invalidate such payments. *See, e.g., Skinner v. Overend*, 190 Minn. 456, 457-58, 252 N.W. 418, 419 (1934); *Petersdorf v. Malz*, 136 Minn. 374, 378-79, 162 N.W. 474, 476-77 (1917). Thus, payments made on a pre-existing debt are not

fraudulent as a matter of law. *Nat'l Sur. Co. v. Wittich*, 184 Minn. 21, 24, 237 N.W. 585, 586 (1931).

Yet in this case, the Receiver seeks to claw back ordinary interest payments made to Alliance under a binding loan participation agreement, because Alliance allegedly made a "profit," while other creditors of Johnston and FUF lost money on more recent fictitious loans. The interest payments received by Alliance, however, were not fraudulent transfers, and the MUFTA is not an appropriate remedy.

B. The Ponzi-Scheme Presumption.

Unable to establish fraudulent intent or lack or reasonably equivalent value, the Receiver advocated for, and the district court adopted, a doctrine adopted by a number of federal courts (but heavily criticized by others) referred to as the Ponzi-scheme presumption. When the Ponzi-scheme presumption is fully applied, profits paid by the transferor are recoverable as fraudulent transfers, even if the recipient was acting in good faith, and without the normal proof required under fraudulent transfer laws. *See Donell v. Kowell*, 533 F.3d 762, 770-71 (9th Cir. 2008).

Although the MUFTA itself requires proof that the actual transfers were made with the requisite intent to defraud or made without receipt of reasonably equivalent value, the Ponzi-scheme presumption presumes that these elements are established as a matter of law by the mere showing that the transferor was involved in a fraudulent Ponzi scheme. *Id.* The presumption was developed in connection with cases where the transferor promised and delivered exorbitant returns on investments, but engaged in little or no legitimate business activity. *See, e.g., In re Polaroid Corp.*, 472 B.R. 22, 43

(Bankr. D. Minn. 2012) (a massive, multi-year scheme that offered, in one instance, promised returns of "20% interest ... 80% annualized ... backed by the entire Polaroid corporation" for a non-existent loan); *Donell*, 533 F.3d 762, 767 (business promised returns of 20% for a non-existent scheme involving purchasing accounts receivables of Malaysian glove manufacturer); *Scholes v. Lehmann*, 56 F.3d 750, 752 (7th Cir. 1995) (20% returns per month generated not from investments, as advertised, but from selling additional interests in business). Importantly, the Receiver cites no case fully applying a Ponzi-scheme presumption where (as here) the allegedly fraudulent payments were made pursuant to a legitimate performing loan agreement from proceeds received from an actual borrower and not from other investors.

Moreover, the presumption goes against the plain language of the Uniform Fraudulent Transfer Act. This has been observed by a handful of federal courts that have rejected the presumption. *See, e.g.*, *In re Carrozella & Richardson*, 286 B.R. 480, 491 (D. Conn. 2002); *In re Unified Commercial Capital*, 260 B.R. 343, 354 (Bankr. W.D.N.Y. 2001).[3] The language of the MUFTA refers to individual transfers – not the debtor's overall business scheme. *See Solow v. Reinhardt (In re First Commercial Mgmt. Grp.)*, 279 B.R. 230, 238-39 (Bankr. N.D. Ill. 2002) (analyzing analogous Illinois Uniform Fraudulent Transfer Act). It contemplates an examination of the transaction at issue, *i.e.* "reasonably equivalent value for in exchange <u>for the transfer</u>." Minn. Stat.

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[3] *See also, Orlick v. Kozyak (In re Fin. Federated Title & Trust)*, 309 F.3d 1325, 1332 (11th Cir. 2002) (holding that recipient of payments from debtor engaged in Ponzi scheme entitled to raise good faith/for value defense); *Balaber-Strauss v. Lawrence (In re Churchill Mortg. Inv. Corp.)*, 264 B.R. 303, 308 (S.D.N.Y. 2001).

§ 513.44(a)(2) (emphasis added); *First Commercial Mgmt. Grp.*, 279 B.R. at 237. Courts assess value by examining the transfer at issue and the surrounding circumstances, not (as the Receiver urges) the value of the debtor's fraudulent enterprise. *Cuthill v. Greenmark, LLC (In re World Vision Entm't.)*, 275 B.R. 641, 657 (Bankr. M.D. Fla. 2002).

C. The Ponzi-Scheme Presumption Applied to the Claims Against Alliance Would be an Improper Expansion of Minnesota Law.

Until the recent decision decisions stemming from the Petters Ponzi scheme, which involved a very different set of facts, no other court in the Eighth Circuit had ever applied the Ponzi-scheme presumption as a device for fact-finding. *Polaroid*, 472 B.R. at 32; *In re Petters Co.*, 499 B.R. 342, 351-52 (Bankr. D. Minn. 2013) (payment of preexisting creditor compared to complex churning of involved investors and invested money "is not only material for the focus of the avoidance remedy; it is decisive.")

The Court of Appeals determined that the Ponzi-scheme presumption actually can be understood to create three separate presumptions: (1) fraudulent intent, (2) a lack of sufficient assets to pay debts, and (3) a lack of reasonably equivalent value. *Finn*, 838 N.W.2d at 598. "The third effect of the Ponzi-scheme presumption is that all profits that an investor in a Ponzi scheme receives, even if taken in good faith, are presumed not to have been received for reasonably equivalent value." *Id.* (citing *Donell*, 533 F.3d at 777-78). The Court of Appeals analyzed Second and Seventh Circuit opinions that justified the presumption of lack of reasonably equivalent value under the Ponzi-scheme presumption on the grounds that profits paid in the course of a Ponzi-scheme cannot be for reasonably equivalent value because "it 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 [an investor] not offset by further investments by him conferred no benefit on the corporations but merely depleted their resources faster." *Id.* at 601-02 (citing *Scholes*, 56 F.3d at 757) (quotations omitted). The Court of Appeals noted that this justification is consistent with the Uniform Act but inapplicable to the Receiver's claims against Alliance in light of the unique facts. *Id.* at 602.

The Court of Appeals went on to distinguish the facts in *Donell* and *Scholes* (two cases heavily relied on by the Receiver) by noting that the "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." *Id.* Accordingly, the Court of Appeals concluded that applying the presumption of lack of reasonably equivalent value to the claims against Alliance would be an extension of the Ponzi-scheme presumption set forth by the federal court in *Donell*, and also an extension of MUFTA's reasonably-equivalent-value defense against actual-fraud claims and the reasonably-equivalent-value element of constructive fraud. *Id.* The Court of Appeals reasoned that such an extension of the law must be done by the Supreme Court or the legislature and, accordingly, it reversed the decision of the district court. *Id.* In unanimously entering judgment in favor of Alliance, the Court of Appeals panel concluded that it did not need to determine if the Ponzi-scheme presumption can <u>ever</u> be applied to claims asserted under the MUFTA – it simply determined that the claims against Alliance did not warrant an extension of Minnesota law. *See id.*

As the Court of Appeals correctly observed, value is given if the transfer satisfies an antecedent debt.[4] *Id.* at 602 (citing Minn. Stat. § 513.43(a) (2012)). Section 513.43(a) "assigns the character of value to the legal result of any payment by a debtor-transferor to its creditor, *i.e.*, the satisfaction or securing of a preexisting debt." *Petters*, 499 B.R. at 352. It applies "anywhere the concept of "value" is legally relevant in a fraudulent-transfer action." *Id.* The Court of Appeals recognized that true value was supplied by Alliance's funding of the loan made by FUF to a legitimate borrower, who repaid FUF the loan principal, plus required interest and fees. *Finn*, 838 N.W.2d at 602. That logical conclusion is bolstered by the fact that "the receiver did not allege in district court, nor does it argue on appeal, that First United's payments to Alliance depleted First United's assets as envisioned by the court in *Donell* or the drafters of the UFTA, or that the underlying loan that Alliance participated in was in any way oversold or nonexistent." *Id.* To the contrary, the fees received by FUF from Mr. Moyes enhanced FUF's resources, rather than diminishing an estate available to other creditors. As such, the Court of Appeals declined to fully apply the Ponzi-scheme presumption in light of the evidence that Alliance received payments in good faith and for reasonably equivalent value – a complete defense to the Receiver's fraudulent transfer claims under the MUFTA. *See id.*

The Court of Appeals decision is consistent with well-established Minnesota law: that payment of a debt owed establishes reasonably equivalent value as a matter of law,

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[4] An "antecedent debt" is a "debtor's ... obligation that existed before a debtor's transfer of an interest in property." *Black's Law Dictionary* 462 (9th ed. 2009).

Kummet, 210 Minn. at 305, 298 N.W. at 247; *Nat'l Sur. Co.*, 184 Minn. at 24, 237 N.W. at 586; that a "preferential" payment is not voidable under the MUFTA, *Thompson v. Schiek*, 171 Minn. 284, 287, 213 N.W. 911, 912 (1927) (stating that preferential payments to creditors can be properly challenged only in bankruptcy proceedings); *Johnson v. O'Brien*, 275 Minn. 28, 31-32, 144 N.W.2d 720, 722 (1966); and that adequate consideration for a transfer is a complete defense, *Watson v. Goldstein*, 174 Minn. 423, 425, 219 N.W. 550, 551 (1928). In sum, Minnesota law consistently holds that the payment to one creditor to the detriment of another, or the preference of one creditor over another, is not enough to make the transfer avoidable.

For example, in *Petersdorf*, the plaintiff wife had a judgment against the defendant ex-husband for alimony and a monetary award in a divorce action. 136 Minn. at 376, 162 N.W. at 475. The divorce arose over the husband's preference for the plaintiff's sister, who lived in the marital household. *Id.* Soon after the divorce action was brought, defendant's father brought a collection action against the ex-husband on two promissory notes and the sister brought an action seeking to recover the value of services rendered in the household. *Id.* Default judgments were entered in both actions. *Id.* Those judgments had priority over the divorce judgment as a lien on defendant's land. *Id.* Plaintiff subsequently brought a fraudulent-conveyance action alleging these transfers were subject to avoidance. There, the Minnesota Supreme Court held that the trial court correctly found that the father's action on the promissory notes was orchestrated by defendant with actual intent to hinder or delay the plaintiff in the collection of the divorce judgment. *Id.* at 377, 162 N.W. at 476. As to the sister's recovery, however, the Court

held that the trial court had erred in finding it fraudulent. *Id.* at 378, 162 N.W. at 476. The household services rendered by the sister constituted reasonably equivalent value for the debt and resulting judgment. *Id.* That the defendant intended to thwart the plaintiff's collection efforts by ensuring the sister had a superior lien did not render sister's judgment fraudulent, but rather merely preferential. *Id.* The Court noted that such a preference can be assailed only in an action for bankruptcy. *Id.* at 379, 162 N.W. at 476.

Many other Minnesota cases have upheld that payments which blatantly preferred one creditor to the detriment of another are not fraudulent transfers. *See, e.g.*, *Johnson*, 275 Minn. at 31-32, 144 N.W.2d at 720 (real property conveyed to son with intent to defraud creditors found to have been exchanged for reasonably equivalent value); *Neubauer v. Cloutier*, 265 Minn. 539, 547, 122 N.W.2d 623, 630 (1963) (conveyance of property to sister and mother 18 days after entry of divorce decree held not fraudulent because mother had cared for grantor's child and sister had advanced grantor "unspecified" sums of money); *Skinner*, 190 Minn. at 457, 252 N.W. at 418 (real and personal property conveyed to son in consideration for past work on farm).

The claim against Alliance involves a documented loan entered in the ordinary course of business in exchange for a reasonable payment of interest, which clearly demonstrates reasonably equivalent value and good faith on the part of Alliance. *See, e.g.*, *Carrozella & Richardson*, 286 B.R. at 484-91 (payment of reasonable interest is reasonably equivalent value); *Unified Commercial Capital*, 260 B.R. at 351 (same). The time value of money is a well-established concept in finance, accounting, and the law. Alliance and its sub-participant lost the use of $3,180,000 for a number of years, while

the borrower, Mr. Moyes, had use of it. Had Alliance not made the loan to Mr. Moyes, it could have loaned that money to somebody else or put it to some other business use.

The interest received on the loan not only reimbursed Alliance for the lost use of its money, but also went towards the overhead of running a bank, and most of the interest was immediately forwarded to a subparticipant. To say that all the interest Alliance received was pure "profit" is simply inaccurate as a matter of common sense. Banks stay in business by charging interest for the use of their money. If Alliance were required to return all interest payments received from Jerry Moyes, it would actually sustain a significant and unfair loss on this transaction.

D. Application of Ponzi-Scheme Presumption by the Bankruptcy Court is Not Precedential and is Factually Distinguishable From This Case.

The Receiver makes much of the fact that the federal bankruptcy court in Minnesota recently applied the Ponzi-scheme presumption to claims involving a "massive, multi-year Ponzi scheme that involved many dozens of lender-investors and tens of thousands of transfers on transactions documented and treated as loans." *Petters*, 499 B.R. at 351. First, this is a federal court case that follows other federal courts in adopting the Ponzi-scheme presumption. It is certainly not controlling authority for this Court on questions of Minnesota state law.

Secondly, the bankruptcy court distinguished the facts in *Petters* from decisions in three different circuits that refused to apply the presumption based on the following factual distinction: the transferors in each case affected a single transactional process to remove a preexisting creditor from a foundering debtor's debt structure. *Compare* 499

B.R. at 351 *with In re Sharp Int'l Corp.*, 403 F.3d 43, 47 (2nd Cir. 2005), *B.E.L.T., Inc. v. Wachovia Corp.*, 403 F.3d 474, 476 (7th Cir. 2005), *and Boston Trading Grp., Inc. v. Burnazos*, 835 F.2d 1504, 1506 (1st Cir. 1987). In each of these decisions, the court found that the specific transfers at issue were payoffs of the lenders' preexisting debts and that no evidence existed to show that the transferor made the transfers with intent to defraud other creditors – even ones whose cash infusions were alleged to have funded or enabled the payoffs. *Sharp Int'l*, 403 F.3d at 56-57; *B.E.L.T., Inc.*, 403 F.3d at 478; *Boston Trading Group*, 835 F.2d at 1506-07). Based on this important distinction, the *Petters* court concluded that "[i]n the level of complexity and (more crucially) in the nature and breadth of the transferor's motivation to make the transfer, the distinction between [the Circuit Court cases] and the situation [in *Petters*] is not only material for the focus of the avoidance remedy: it is decisive." *Petters*, 499 B.R. at 351.

Finally, in applying the presumption, the *Petters* court emphasized a rule adopted in numerous jurisdictions: in order to apply the Ponzi-scheme presumption, "courts must be sure that the transfers sought to be avoided are related to the scheme." *Id.* at 353 (citing *In re Manhattan Inv. Fund*, 397 B.R. 1, 11 (S.D.N.Y. 2007)). Relatedness is best equated to the concept of being "in furtherance of" the Ponzi scheme, in the parlance of the presumption – a matter mostly of fact but with some legal dimension." *Id.* In the present case, there is no evidence that the payments to Alliance were in furtherance of the FUF Ponzi-scheme; in fact, they were made pursuant to the express language of the parties' loan agreement and in exchange for value provided by Alliance (use of its funds) that was put to legitimate business use by Mr. Moyes.

E. The Ponzi-Scheme Presumption Does Not Fit the Circumstances Here.

Beyond the fact that it is inconsistent with purpose and text of the MUFTA, the Ponzi-scheme presumption is simply a bad fit for the claims against Alliance. Typically, the cases that have applied the presumption involve complex schemes where the defendant transferee was paid with proceeds from later investors. In this case, however, the underlying transaction was a single legitimate and performing lending transaction: FUF made the loan to Jerry Moyes and Jerry Moyes made payments to FUF. While FUF separately created fictitious loans sold to other banks, the loan funded by Alliance was legitimate and distinguishable from other loans made by FUF. In short, the payments to Alliance originated from an actual lending transaction did not further FUF's scheme.

As stated by this Court, a Ponzi scheme is commonly defined as follows:

> A fraudulent investment scheme in which money contributed by later investors generates artificially high dividends or returns for the original investors, whose example attracts even larger investments.
>
> Money from the new investors is used directly to repay or pay interest to earlier investors, usually without any operation or revenue-producing activity other than the continual raising of new funds. This scheme takes its name from Charles Ponzi, who in the late 1920s was convicted for fraudulent schemes he conducted in Boston.

In re Murrin, 821 N.W.2d 195, 197 n.1 (Minn. 2012) (citing *Black's Law Dictionary* 1198 (8th ed. 2004)) (emphasis added).

Even under presumptions of the kind the Receiver urges this Court to adopt as an expansion of Minnesota law with respect to investors who enjoy profits arising from such classic Ponzi schemes, the burden must be on the Receiver to prove predicate facts: that a

Ponzi scheme existed and that the transaction at issue was in furtherance of the scheme. *See Gold v. First Tenn. Bank, N.A. (In re Taneja)*, No. 08-13293-RGM, 2012 WL 3073175 at *4 (Bankr. E.D. Va. 2012); *Kapila v. Phillips Buick–Pontiac–GMC Truck (In re ATM Fin. Servs.)*, No. 6:08-bk-969-KSJ, 2011 WL 2580763 at *5 (M.D. Fla. June 24, 2011). Several courts have stated that the Ponzi-scheme presumption does not apply where the transfers at issue are so unrelated to the Ponzi scheme that they do not serve to further the Ponzi scheme. *Silverman v. Meister, Seelig & Fein, LLP (In re Agape World, Inc.)*, 467 B.R. 556, 570 (Bankr. E.D.N.Y. 2012); *Picard v. Madoff*, 458 B.R. 87, 105 (Bankr. S.D.N.Y. 2011); *Manhattan Inv. Fund*, 397 B.R. at 11.

Such is the case here. The payments to Alliance were made pursuant to a legitimate loan transaction, and thus did not harm other banks who might have unwittingly funded separate and fictitious loans. Further, the payments received by Alliance did not simply originate from "a continuing churning of involved investors and invested money." *Petters*, 499 B.R. at 351. Instead, the payments originated from an actual borrower under an actual loan.

F. The Ponzi-Scheme Presumption is Bad Policy.

Aside from the facts of this case, the Ponzi-scheme presumption is simply not an appropriate application of existing Minnesota fraudulent-transfer law. Courts rejecting the presumption have recognized that while it is an effort to provide a "just" solution to the losses suffered by investors by reallocating those losses, such is a misuse of the fraudulent transfer laws. *Carrozella & Richardson*, 286 B.R. at 489; *Unified Commercial Capital*, 260 B.R. at 349-50. Examining the statutory scheme for avoiding fraudulent

transfers, the *Unified Commercial Capital* court observed that the federal bankruptcy code allows preferential transfers made within 90 days of bankruptcy filing to be recovered and reallocated equitably among creditors and that the fraudulent transfer provisions and state fraudulent transfer laws apply to all other transfers. 260 B.R. at 350 (citing 11 U.S.C. § 547(b) (2000)). The court observed that the Ponzi-scheme presumption in effect transforms fraudulent-conveyance statutes to "super preference" statutes that allow the court to undo merely preferential transfers (regardless of whether they independently meet the requirements of the fraudulent transfer statutes) long before the cut-off for the undoing of preferences. *Id.* This criticism is particularly poignant in light of the well-entrenched line of Minnesota cases explicitly holding that the fraudulent-transfer act is not to be used to undo merely preferential transfers. *See, e.g., Skinner*, 190 Minn. at 457-58, 252 N.W. at 419; *Nat'l Sur. Co.*, 184 Minn. at 24, 237 N.W. at 586; *Petersdorf*, 136 Minn. at 378-79, 162 N.W. at 476-77.

Courts have further criticized the Ponzi-scheme presumption as working an injustice and question why a Ponzi scheme should be treated so differently from other fraudulent schemes or even bankrupt consumers who borrow money (and pay interest) to do such things as take a vacation knowing that they will never be able to pay it back. *See, e.g., Unified Commercial Capital*, 260 B.R. at 353-54. In those situations, creditors are allowed to keep a reasonable return on money loaned. *Id.* Moreover, taking the Ponzi-scheme presumption to its logical conclusion would allow recovery of payments made to <u>any</u> creditor such as utility companies, landlords, or any other vendor the debtor had once done business with so long as that creditor made some sort of "profit" on the

relationship. *Carrozella & Richardson*, 286 B.R. at 490. As the court observed in *World Vision Entertainment*, "[s]imply because a debtor conducts its business fraudulently does not make every single payment by the debtor subject to avoidance." 275 B.R. at 658.

Thus, to the extent this Court decides to announce a broad ruling beyond the facts of this case to address the Ponzi-scheme presumption as used in other contexts, it should reject automatic, knee-jerk application of the third part of the presumption under the MUFTA. As noted in the cases discussed above, the language of the MUFTA is directed to the transfers "at issue." And rejection of the third part of the presumption is consistent with the overriding purpose of Minnesota's fraudulent-transfer law, which "is to prevent debtors from putting property which is available for the payment of their debts beyond the reach of their creditors," *Butler*, 552 N.W.2d at 231 (quotations omitted), not to remedy preferences among creditors, *Thompson*, 171 Minn. at 287, 213 N.W. at 912. Yet that is precisely what the Receiver is attempting to do here by seeking to recover transfers made in satisfaction of ordinary commercial agreements.

II. ALTERNATIVELY, IF THIS COURT APPLIES THE PONZI-SCHEME PRESUMPTION, ALLIANCE'S LIABILITY SHOULD BE LIMITED TO ACTUAL PROFITS RECEIVED AND RETAINED.

Throughout this action, the Receiver has sought to recover only interest and fee payments received by Alliance (which the Receiver characterizes as "profits"), not payments of principal. (*See* A12-14.) Of the amount the Receiver seeks to recover, $560,895 constitutes interest and $38,652 constitutes fees (as accounted for in loan records) received more than six years before commencement of this action. (R.App.086-99; R.App.126-30.) Thus, even if the Court disagrees with the prior defenses raised,

$599,547 of the Receiver's claim should be time-barred. In addition, of the more limited remaining amount, Alliance as a conduit immediately wired $368,902 (roughly two-thirds of all payments) in interest to Security, the actual transferee. Thus, only $272,757 represents interest and fee payments actually received and retained by Alliance within six years from commencement of the lawsuit. The judgment entered by the district court, plus prejudgment interest awarded over Alliance's objection (although the district court in its January 30, 2013 order noted the unfairness to Alliance in doing so), is more than $1 million greater than what was actually retained by Alliance within the six-year statute.

Because the claims advanced by the Receiver in this case are novel, there appears to be no Minnesota appellate decisions precisely on point with respect to application of the statute of limitations to the "claw back" of ordinary interest under the Fraudulent Transfer Act. However, several federal courts have recognized that the time limits applicable to fraudulent-transfer claims begin to run at the time of each allegedly fraudulent transfer. *Warfield v. Alaniz*, 453 F. Supp. 2d 1118, 1130-31 (D. Ariz. 2006), *aff'd*, 569 F.3d 1015 (9th Cir. 2009); *Neilson v. Union Bank of Cal., N.A.*, 290 F. Supp. 2d 1101, 1145 (C.D. Cal. 2003). This result is consistent with the language of the MUFTA, which scrutinizes each individual transfer. *See* Minn. Stat. § 513.44 (2012). The district court relied on the *Donell* case from the Ninth Circuit to adopt a simple "netting" rule, as urged by the Receiver, and ignored the way the parties to the transaction actually characterized the payments as specified by the loan documents. *Donell*, however, involved a pure Ponzi scheme and a fictitious business enterprise, and the court noted the difficulty in determining whether the payments were profit or

principal. 533 F.3d at 774. No such difficulty exists here, where the transaction was a well-documented, ordinary commercial loan. Because the Court can easily distinguish the amount of interest paid to and kept by Alliance, any fraudulent-transfer liability imposed should be limited to Alliance's actual "profits," not super-inflated to include amounts that Alliance immediately transferred to its sub-participant.

Further, in its order granting summary judgment against Alliance for the entire amount sought by the Receiver, the district court failed to address the fact that Alliance did not actually retain two-thirds of the alleged profits the Receiver sought to claw back. Those funds were immediately passed on to Security Financial Bank. Since Alliance never enjoyed those alleged profits or retained any form of ownership, Alliance certainly should not be liable for their return under Ponzi-scheme presumption or otherwise. Alliance was a "mere conduit" to the actual transferee, Security. Section 550 of the Bankruptcy Code, 11 U.S.C. § 550 (2012), defines liability for a transfer found to be fraudulent under bankruptcy law. Like the Minnesota Fraudulent Transfer Act, Section 550 provides that a creditor may recover the value of the asset fraudulently transferred from the initial transferee. *Compare* 11 U.S.C. § 550 ("initial transferee") *with* Minn. Stat. § 513.48(b)(1) (2012) ("first transferee").

Federal Courts have repeatedly held that a recipient of a transfer who acts merely as a financial intermediary and passes the funds onto the true transferee is not an "initial transferee" for purposes of Section 550. *See, e.g., Bonded Fin. Servs. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988). In *Bonded Financial Services*, the Seventh Circuit Court of Appeals recognized that holding a "mere conduit" liable as an "initial

transferee" would not further the purposes of fraudulent-conveyance law. 838 F.2d at 893. Accordingly, the court established a standard for liability as the initial transferee: the recipient must have "dominion over the money or other asset, the right to put the money to one's own purposes." *Id.* The court explained "[w]hen A gives the check to B as agent for C, then C is the 'initial transferee'; the agent may be disregarded." *Id.*

Bonded Financial Services and the rule it endorses were followed in a case with circumstances identical to this one. *See Riederer v. Northern Capital, Inc. (In re Brooke Corp.)*, 458 B.R. 579 (Bankr. D. Kan. 2011). In *Brooke*, a lead bank sold portions of a loan to other banks and passed along the payments pursuant to participation agreements. 458 B.R. at 582-83. Some of the debtor's payments on the loan were found to be fraudulent, and the question before the court was whether the lead participant on the note was liable for the entirety of the fraudulent transfers or merely for the portion actually retained by the lead participant. *Id.* at 585. The court noted liability depended on whether the lead bank was a mere conduit or the initial transferee when it received the fraudulent payments from the debtor and immediately forwarded the participants' portion of the payments. *Id.* Applying the rule from *Bonded Financial*, the court noted, "dominion or control means *legal* dominion or control," and requires both control over and the legal right to use the funds. *Id.* at 586. Applying this definition to the participation agreements at issue, the court held that the lead bank was a mere conduit for the payments received. *Id.* at 587. The court noted that as to the portion of the loan that had been sold on to other banks, the lead bank acted as administrator or agent and not as owner of the funds. *Id.* It did not have any dominion or control over the funds as it had a

legal and contractual obligation to pay the funds to the participants. *Id.* The court held that the participants were the real recipients of the allegedly fraudulently transfers. *Id.*

The analysis in *Brooke* applies squarely to the facts of this case. Alliance sold a non-recourse ownership interest in the loan to Security. (R.App.010.) When it received payments from First United, it held those payments only as an agent for Security and almost immediately forwarded Security's share by wire. (*Id.*) Alliance exercised no legal dominion over the funds, as it was legally obligated to pay the funds to Security. Thus, Alliance was a mere conduit and not the first transferee and should not be required under any circumstance to repay interest it did not keep.

CONCLUSION

For the above-stated reasons, Alliance Bank respectfully requests that the Court affirm the Court of Appeals' decision directing that judgment be entered in favor of Alliance on all claims.

Dated: 1/27/2014

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CERTIFICATE 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 the brief is 8,291 words and was prepared using Microsoft Word 2010.

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