UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

R.J. ZAYED, In His Capacity As Court-Appointed Receiver For The Oxford Global Partners, LLC, Universal Brokerage, FX, and Other Receiver Entities

Plaintiff,

vs.

ASSOCIATED BANK, N.A.,

Defendant.

Case No. 13-cv-00232 (DSD-JSM)

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANT'S MOTION TO DISMISS

<u>REDACTED VERSION</u>

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INTRODUCTION

Trevor Cook, Patrick Kiley, and others perpetrated a Ponzi scheme that defrauded investors of millions of dollars (the "Cook/Kiley fraud"). Cook and Kiley have since been convicted and incarcerated. Chief Judge Davis appointed R.J. Zayed as Receiver to marshal the investors' assets and to repay them. *SEC v. Cook*, 9-cv-3333 (D. Minn.) [Doc. 13]. The Receiver's status reports indicate that, primarily through claw-back actions, he has recovered millions of dollars for the investors. *Id.* [Doc. 1033]. These are laudable efforts.

But the current suit—in which the Receiver sets his sights on Associated Bank ("Associated")—is an entirely different animal. The Receiver is overreaching his legal authority. This suit asserts claims that the Receiver is not permitted to pursue, obstructs the rights of the very persons whom the Receiver seeks to benefit, rests on allegations insufficient to state a claim, and, if permitted to go forward, would interfere with Minnesota law designed to ensure that the public enjoys a reliable, smoothly-functioning banking system.

It bears emphasis that this is not the first time that plaintiffs have sued Associated for the Cook/Kiley fraud. A group of investors sued Associated in Wisconsin state court on aiding and abetting claims identical to two of those the Receiver asserts here; the court dismissed the action, and the dismissal was affirmed on appeal. *See Grad v. Associated Bank N.A.*, 801

N.W.2d 349 (table), 2011 WL 2184335 (Wis. Ct. App. 2011). Another group of investors sued Associated in this Court but voluntarily dismissed their claims. These prior cases illustrate two important points.

First, not only are the investors capable of suing Associated, they are the correct parties to do so. By contrast, the Receiver, who stands "in the shoes" of Cook, Kiley, and their sham companies, cannot sue Associated under the *in pari delicto* doctrine that bars fraudsters from suing others for allegedly aiding and abetting their own wrongdoing. And even if the Receiver did not stand in the shoes of the fraudsters, but rather could assert the claims of the investors, his claims would be barred by *res judicata*, as some investors already sued (and lost) in Wisconsin. What is more, the Receiver lacks prudential standing to pursue this matter. That doctrine prevents suits, such as this one, in which the plaintiffs' rights are derivative of the rights of other parties who themselves would be the more effective and appropriate advocates of the rights at issue.

All of these doctrines discussed above reflect a common theme. Only the proper party (*i.e.*, the investors, and not the Receiver) may bring this suit. That is not just Minnesota law, it is also good policy. The investors, as the injured parties, are best positioned to determine whether to sue Associated (yet again), and on what terms litigation should be resolved.

Second, even if the Receiver could bring this suit, the Complaint fails to state a claim for the same reasons that the *Grad* lawsuit was dismissed: it rests entirely on allegations that Associated (i) performed routine banking transactions and (ii) failed to spot "red flags," or otherwise catch and prevent the Cook/Kiley fraud. [redacted] That is the antithesis of knowingly aiding a Ponzi scheme. Courts consistently hold that allegations such as the Receiver's here do not state a claim for aiding and abetting.

Rejecting claims like the Receiver's, which seek to impose liability in hindsight for routine banking transactions, is essential for several reasons. One, permitting such claims would chill banking activity. *See Witzman v. Lehrman, Lehrman & Flom*, 601 N.W.2d 179, 189 (Minn. 1999) ("[i]f we were to recognize that such routine services" are sufficient to permit an aiding and abetting claim, "then it would be the rare [professional] indeed who would not be subject to automatic liability merely because his client happened to be a tortfeasor"). Two, allowing such claims would impose "near-strict liability for the torts of [a bank's] clients," leading to "a devastating impact on commercial relationships." *El Camino Res., Ltd. v. Huntington Nat'l Bank*, 722 F. Supp. 2d 875, 908 (W.D. Mich. 2010). In Minnesota, the commercial relationship between bank and customer requires a bank to, among other things, afford its customers prompt access to funds on deposit. If banks were liable in a situation like this, it would impose new, time-intensive duties on banks to police their customer's transactions, interfering with Minnesota's carefully considered policy.

BACKGROUND

A. Associated Bank.

Associated Bank is a federally-chartered national banking association headquartered in Green Bay, Wisconsin. Founded in 1970, with many of its offices tracing their roots to the 1880s and 1890s, Associated offers banking and financial services throughout Wisconsin, Illinois, and Minnesota. Associated has over 25 branches in Minnesota.

B. The Cook/Kiley fraud.

The Cook/Kiley fraud began in mid-2005. *See* Compl. ¶ 8, *R.J. Zayed v. Peregrine Financial Corp.*, 12-cv-00269 (D. Minn.) [Doc. 1]. Oxford Global Partners, LLC, Universal Brokerage, FX, Crown Forex LLC and other related entities (the "Receivership Entities") maintained accounts, allegedly used in furtherance of the Cook/Kiley fraud, at several leading financial institutions, including Wells Fargo, Charles Schwab, Saxo Bank, Credit Suisse, and PFG Best. *See* Compl. Ex. 12 ¶¶ 5, 48; *SEC v. Cook*, 9-cv-3333 (D. Minn.) [Doc. 100]. In 2008, the Receivership Entities for the first time opened accounts at

Associated. Compl. ¶ 29. In summer 2009, the Cook/Kiley fraud came to light and collapsed. *Id*. Ex. 12 ¶ 17; *id*. Ex. 25 ¶ 35.

At the heart of the Complaint are allegations that Associated should have spotted certain red flags, investigated further, and ultimately stopped the Ponzi scheme: [redacted]

Although (1) Trevor Cook—one of the architects of the Cook/Kiley fraud whose plea agreement obligates him to cooperate with the Receiver—has been deposed, (2) Christopher Pettengill, another of the convicted fraudsters, has provided the Receiver with an affidavit for use in this action (Compl. Ex. 20), and (3) other principals of the Cook/Kiley fraud have testified in court, either for the prosecution or in their own defense, the Receiver does not allege that any witness asserts that Associated was aware of the Cook/Kiley fraud. [redacted] The Receiver also appends to his Complaint a Sarles affidavit; that testimony similarly confirms a lack of knowledge. *See id*. Ex. 4 ¶ 29.

Nevertheless, the Receiver argues that Associated's knowledge may be "inferred" from what the Receiver characterizes as "circumstantial evidence." *See, e.g.*, Compl. ¶ 13. The "circumstances" on which the Receiver relies are: [redacted]

C. Prior proceedings.

In 2009, some investors sued Associated in Wisconsin. *See Grad v. Associated Bank, N.A.*, 09-cv-2949 (Wis. Cir. Ct.). They asserted claims for negligence, aiding and abetting breach of fiduciary duty, and aiding and abetting conversion. Like here, plaintiffs alleged that "Associated Bank ignored obvious red flags symptomatic of fraud or other illicit activity." *Grad* Compl. ¶ 3, App. 2. They alleged largely the same supposed red flags as here, *e.g.,* Minnesota registration had not yet been obtained for Crown Forex LLC (Grad *id.* ¶¶ 50-51, App. 12), Kiley's background was inconsistent with the sophistication of the products he sold (*id.* ¶ 54, App. 13). On April 8, 2010, the trial court dismissed the Complaint. App. 25. On June 7, 2011, the Wisconsin Court of Appeals affirmed the dismissal. *Grad*, 801 N.W.2d 349.

On November 4, 2009, a group of over fifty individual plaintiffs named Associated as a defendant in *Phillips v. Cook*, 0:09-cv-01732-MJD-JJK (D. Minn.). They asserted a negligence claim against Associated based on allegations that Associated "failed to recognize and investigate 'red flags' and indicia of fraud." *Phillips* Am. Compl. ¶ 1,605 [Doc. 197]. On December 9, 2009—the day before Associated's motion to dismiss was due—plaintiffs voluntarily dismissed their claims against Associated.

ARGUMENT

The Complaint has two fatal flaws: the Receiver cannot pursue the asserted claims, and the Complaint fails to allege a plausible claim for relief.

I. The Receiver May Not Pursue These Claims.

Because the Receiver "stands" in the "shoes" of the Receivership Entities, he may assert claims those entities possess, such as a claim to claw back fraudulent transfers to outside parties. *Kelley v. Coll. of St. Benedict*, 2012

WL 5309501, at *3 (D. Minn. 2012). This is the traditional and proper role of an equity receiver.

Here, however, the Receiver seeks to do something drastically different: he has sued Associated for allegedly aiding the very fraudsters in whose shoes he now stands. To do so, the Receiver asserts an "injury" that is really the investors' injury. As the Receiver explains it, the injury is that the Receivership Entities "now owe the defrauded creditors" for the Receivership Entities' own wrongdoing. Compl. ¶¶ 83, 88, 94, 98.[1]

This artifice is impermissible. For multiple reasons, the individual investors, not the Receiver, must bring any claims against Associated.

A. The *in pari delicto* doctrine bars this action.

"The doctrine of *in pari delicto* is the principle that a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing." *Grassmueck v. Am. Shorthorn Ass'n*, 402 F.3d 833, 837 (8th Cir. 2005) (quotation omitted). The doctrine "is an affirmative defense," "but dismissal under Rule 12(b)(6) may be proper if the face of the complaint establishes the requirements of the defense." *Peterson v. Winston & Strawn, LLP*,

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[1] The Receiver, however, does not plead that any Receivership Entity has yet been found to owe money, and thus the claim has not ripened. If he cannot show a "final judgment or payment of a judgment," this action, which is effectively a "claim for contribution" would not be "ripe for adjudication." *Schaffner v. Crown Equip. Corp.*, 2012 WL 70588, at *4 (N.D. Cal. 2012).

2012 WL 4892758, at *3 (N.D. Ill. 2012). Here, the Complaint establishes the defense.

The *in pari delicto* defense "operates to prevent wrongdoers at equal fault from recovering against one another." *Christians v. Grant Thornton, LLP*, 733 N.W.2d 803, 814 (Minn. Ct. App. 2007). It applies "to tortious transactions based upon fraud or similar intentional wrongdoing," as "[g]enerally, anyone who engages in a fraudulent scheme forfeits all right to protection, either at law or in equity." *State by Head v. AAMCO Automatic Transmissions, Inc.*, 199 N.W.2d 444, 448 (Minn. 1972) (quotation omitted); *see also F&H Inv. Co. v. Sackman-Gilliland Corp.*, 728 F.2d 1050, 1054 (8th Cir. 1984). This stems from the rule that "[a]n intentional tortfeasor is prohibited from seeking contribution from other joint tortfeasors." *Oelschlager v. Magnuson*, 528 N.W.2d 895, 899 (Minn. Ct. App. 1995).

Christians is particularly instructive. A corporation's bankruptcy trustee (a position akin to the Receiver) brought claims against an auditor. *Christians*, 733 N.W.2d at 807-08. The trustee asserted that the auditor's erroneous report caused the company injury. But it was the company itself that had failed to disclose material transactions to the auditor. *Id.* at 814. Even assuming the auditor had some liability, the court concluded that *in pari delicto* barred the trustee's claims because the company "bears at least substantially equal responsibility for the injury it seeks to remedy." *Id.* (quotation omitted).

"[W]hen a defendant's only sin is its failure to prevent transgressions by the plaintiff, no benefit flows to the public from rewarding the transgressor." *Id.* at 815 (quotation omitted).

This case is no different; the Receivership Entities (via the Receiver) argue that Associated should have [redacted] but they may not recover on the theory that Associated Bank failed to stop *them* from committing misconduct.

The appointment of the Receiver in this action does not alter the *in pari delicto* defense. *Christians* again controls. There, the trustee contended that the *in pari delicto* defense "should not apply to bankruptcy trustees as a matter of public policy because it would harm innocent creditors," but the court disagreed, holding that "courts regularly consider in pari delicto defenses and act to bar trustee claims on that basis despite the inevitable harm to creditors." 733 N.W.2d at 814. Because "[a] federal equity receiver is akin to a bankruptcy trustee" (*Kelley*, 2012 WL 5309501, at *3), *Christians* governs this case. This reflects the Minnesota rule that a receiver stands "in the shoes" of the receivership entities and thus is bound by any defenses that would apply to them. *Dickson v. Baker*, 77 N.W. 820, 821 (Minn. 1899).

Courts in other jurisdictions have dismissed materially identical suits by receivers on the ground of *in pari delicto*. For example, in *Knauer v. Jonathon Roberts Financial Group, Inc.*, 348 F.3d 230, 232 (7th Cir. 2003), a receiver sued broker-dealers that licensed Ponzi fraudsters as securities representatives. The Seventh Circuit affirmed dismissal, concluding that "[t]he doctrine of *in pari delicto* … applies to defeat the receiver's claims." *Id.* at 238.[2]

Similarly, in *Myatt v. RHBT Financial Corp.*, 635 S.E.2d 545, 548 (S.C. Ct. App. 2006), the court affirmed summary judgment in favor of a bank in circumstances nearly identical to this suit. A federally-appointed receiver alleged that the bank aided and abetted a fraudster who operated an illegitimate investment scheme. *Id.* at 546-47. Because the receiver "was seeking tort damages from the Bank for its actions regarding the accounts" instead of "seeking to recover diverted funds from the Bank," the court concluded that "the receiver of a corporation used to perpetuate fraud may not seek recovery against an alleged third-party co-conspirator in the fraud." *Id.* at 548.

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[2] *Knauer* distinguished an earlier decision, *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995), which stated that "the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated." *Knauer* held that *Scholes* is limited to receivers' claims for fraudulent conveyance—a traditional receivership function. *Knauer*, 348 F.3d at 236. The court emphasized that *Scholes* does not reach "a claim for tort damages from entities that derived no benefit from the embezzlements, but that were allegedly partly to blame for their occurrence." *Id.* Moreover, the Seventh Circuit later confirmed that *Scholes*'s statement about the *in pari delicto* defense "is dictum [because] *Scholes* did not entail a *pari delicto* defense." *Peterson v. McGladrey & Pullen, LLP*, 676 F.3d 594, 599 (7th Cir. 2012).

And in *Hays v. Pearlman*, 2010 WL 4510956, at *5-7 (D.S.C. 2010), the court dismissed, on the basis of *in pari delicto*, a receiver's claims against a lawyer who allegedly aided a Ponzi fraudster.

In other litigation, the Receiver pointed to certain Minnesota cases for the proposition that *in pari delicto* is not a bar to a receiver pursuing a claim for fraudulent conveyance. *See* Pl.'s Mem. of Law in Opp. to PFG's Mot. to Transfer Venue, at 8 n.3, *Zayed v. Peregrine Financial Group*, No. 12-cv-269 (D. Minn.) [Doc. 21] (citing *German-Am. Fin. Corp. v. Merchs.' & Mfrs.' State Bank*, 225 N.W. 891 (Minn. 1929); *Magnusson v. Am. Allied Ins. Co.*, 189 N.W.2d 28 (Minn. 1971); *Bonhiver v. Graff*, 248 N.W.2d 291 (Minn. 1976)). But that precedent is not relevant here.

German-American Financial Corp. is limited to the fraudulent conveyance context, and *Bonhiver* and *Magnusson* apply to a different type of receiver with powers that a federal equity receiver cannot invoke. The "receiver" at issue in those cases was a liquidator—a unique creature of statute, appointed by the state commissioner of insurance, who stood in the shoes of the creditors. *Bonhiver*, 248 N.W.2d at 296; *Schacht v. Brown*, 711 F.2d 1343, 1346 n.3 (7th Cir. 1983) (in *Bonhiver*, state law "authorized the liquidator to assert claims of creditors"); *Reider v. Arthur Andersen, LLP*, 784 A.2d 464, 479-80 (Conn. Super. Ct. 2001) (same). Because the receiver was not asserting the corporation's claims, he was "not bound by the fraudulent acts of a former officer of the corporation." *Bonhiver*, 248 N.W.2d at 296.

This case, however, involves a federal receiver, who "may sue only on behalf of the entity (or person) in receivership, not third parties." *Kelley*, 2012 WL 5309501, at *3. The Receiver here, therefore, cannot avoid *in pari delicto* by stepping into the shoes of the creditors. *Christians*, which expressly contemplated *Bonhiver* (733 N.W.2d at 810), demonstrates that *in pari delicto* applies here.[3]

B. *Res judicata* bars the Receiver's claims.

If, however, the Receiver somehow could step into the shoes of the creditors in order to avoid the *in pari delicto* doctrine, then *res judicata* would bar this suit. Some of the investors sued Associated in Wisconsin and lost. If the Receiver represents their rights, he cannot pursue this action. To the extent that the other investors (who were not present in Wisconsin) wish to press a claim, they may do so in their own name. Otherwise, the Receiver and individual investors who sued in Wisconsin could take multiple bites at the same apple.

Res judicata precludes "a subsequent lawsuit on the same cause of action as to matters actually litigated and as to other claims or defenses that

[3] If there is any doubt as to Minnesota law, this question may warrant certification to the Minnesota Supreme Court. *See* Minn. Stat. § 480.065(3); *Reiland v. Sullivan*, 2008 WL 2080974 (D. Minn. 2008).

could have been litigated." *SMA Servs., Inc. v. Weaver*, 632 N.W.2d 770, 773 (Minn. Ct. App. 2001). There are three requirements: (1) "there was a final judgment on the merits," (2) "a second suit involves the same cause of action," and (3) "the parties to both were identical or were in privity with identical parties." *Id.*

Here, the Wisconsin lawsuit was dismissed with prejudice on the merits. *See* Revised Order, App. 25. And *Grad* involved the same claims against Associated, *i.e.*, that Associated "aided and abetted" the Receivership Entities' "breach of a fiduciary duty to [the investors] and conversion of [the investors'] property." *Grad*, 801 N.W.2d 349, at *1. Moreover, the *Grad* plaintiffs "could have" litigated these claims in Wisconsin. *SMA Servs.,* 632 N.W.2d at 773.

If the Receiver represents the rights of creditors, then he is in privity with the *Grad* plaintiffs. *See Lamson v. Towle-Jamieson Inv. Co.*, 245 N.W. 627, 628 (Minn. 1932). "Privity does not follow one specific definition, but rather expresses the idea that a judgment should also determine the interests of certain non-parties closely connected with the litigation." *Reil v. Benjamin*, 584 N.W.2d 442, 445 (Minn. Ct. App. 1998).

In *Lamson*, a corporation's receiver sued for the value of a farm, and the defendants prevailed. 245 N.W. at 628. Later, an individual creditor of the corporation sued the same defendants seeking the same relief. *Id.* at 627.

That creditor, the court concluded, was in privity with the receiver, who acted for his benefit. *Id*. at 628. And those "in privity with an unsuccessful litigant are as much bound by the judgment finally defeating him as is the litigant himself." *Id*.; *see also Javitch v. Gottfried*, 2007 WL 81857 (N.D. Ohio 2007) (settlement by investors in a fraudulent investment scheme barred subsequent claim by a receiver); *Britt v. Vernon*, 2006 WL 2843626 (E.D. Cal. 2006) (receiver's settlement precluded a claim by a creditor against the same defendant).

Barring this action pursuant to *res judicata* is not unfair to the other investors; if they wish to sue Associated, they can do so in their own name. Indeed, other investors did so at one point. At bottom, if the Receiver is litigating on the investors' behalf, he cannot litigate a claim that the *Grad* plaintiffs have already lost.

C. The Receiver lacks standing.

Together, the preceding points demonstrate that the Receiver is not the proper litigant here. Instead, the individual investors should be the ones to sue. This provides yet another basis to dismiss.

"A party invoking federal jurisdiction must establish that he has met the requirements of both constitutional *and* prudential standing." *Delorme v. United States*, 354 F.3d 810, 815 (8th Cir. 2004) (emphasis added). Prudential standing provides "assurance that the most effective advocate of the rights at issue is present to champion them." *Duke Power Co. v. Carolina Envtl. Study Grp., Inc.*, 438 U.S. 59, 80 (1978). Even if a "plaintiff has alleged injury sufficient to meet the 'case or controversy' requirement" of Article III standing, the plaintiff cannot rely on injuries to third parties. *Id.* Prudential standing bars claims in which the "cause of action is founded on a duty owed to a third party." 33 Charles Alan Wright & Charles H. Koch, Federal Practice & Procedure § 8413 (2012).

The prudential standing doctrine applies to exactly this type of suit. It is the *investors* who were defrauded by the Ponzi scheme, who were injured by any breach of fiduciary duty, and whose property was converted. So, even if the Receiver could bring this claim, prudential considerations demonstrate the he is not the proper litigant.

Permitting this suit to proceed with the Receiver representing investors, either *de jure* or *de facto*, would risk unfair and potentially adverse consequences. If the Receiver does litigate this case, it will likely have preclusive effect on the individual investors. *See*, *supra*, 14-15. Permitting the Receiver to proceed would, accordingly, violate the "deep rooted historic tradition that everyone should have his own day in court." *Richards v. Jefferson Cnty.*, 517 U.S. 793, 798 (1996) (quotation omitted).

The Receiver's suit is particularly troubling as there is no means for investors to opt-out. In the class-action context, "due process requires at a minimum that an absent plaintiff be provided with an opportunity to remove himself from the class" through an opt-out mechanism. *Phillips Petro. Co. v. Shutts*, 472 U.S. 797, 812 (1985). Here, however, the Receiver—litigating as a volunteer—could bar individual investors from being masters of their own claims. It is the individuals who should decide whether to sue and how to resolve that litigation—just as several investors have already done. Moreover, it is the investors who should determine what to pay their lawyers for any recovery they receive, rather than have the Receiver dictate the terms of the representation. Win or lose, the Receiver will be paid from funds the Receiver has gathered for the investors. Accordingly, the investors, not the Receiver, should determine whether a suit against Associated is a wise investment of their assets.

II. The Complaint Fails To State A Claim For Relief.

Setting aside the Receiver's inability to prosecute this suit, the Complaint fails to plead sufficient factual allegations "to state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quotation omitted). A claim is not facially plausible if it is based on "naked assertion[s] devoid of further factual enhancement." *Id.* (quotation omitted). "[L]egal conclusions or 'formulaic recitation of the elements of a cause of action'" are not to be taken as true, and "may properly be set aside." *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 594 (8th Cir. 2009).

Additionally, the heightened pleading standards of Fed. R. Civ. P. 9(b) apply to allegations of aiding and abetting fraud. *E-Shops Corp. v. U.S. Bank Nat'l Ass'n*, 678 F.3d 659, 663 (8th Cir. 2012). The same is true of claims for aiding and abetting breach of fiduciary duty and conversion "when the underlying acts are allegedly fraudulent." *Silverman Partners, L.P. v. First Bank*, 687 F. Supp. 2d 269, 288 (E.D.N.Y. 2010). Here, as in *Silverman*, each claim is inextricably linked with the allegedly fraudulent acts of the Receivership Entities. *See* Compl. ¶ 86 (fiduciary duty claim turns on "fraudulent" activity that "fuel[ed] the Ponzi scheme"); *id.* ¶¶ 92-93 (conversion claims turns on fraudsters using "fictitious" accounts). The Receiver thus must plead "the who, what, where, when, and how" of the alleged fraud. *United States ex rel. Joshi v. St. Luke's Hosp., Inc.*, 441 F.3d 552, 556 (8th Cir. 2006).

A. The Complaint fails to state claims for aiding and abetting.

Minnesota recognizes aiding and abetting liability where (1) the primary tortfeasor committed a tort that injured the plaintiff, (2) the defendant knew that the primary tortfeasor's conduct constituted a breach of duty, and (3) the defendant substantially assisted or encouraged the primary tortfeasor in the achievement of the breach. *Witzman v. Lehrman, Lehrman & Flom*, 601 N.W.2d 179, 187 (Minn. 1999). The claims here are deficient because, even if the Receivership Entities committed the underlying torts, the Receiver has not and cannot plead that Associated substantially assisted the wrongful acts or that Associated knew of the wrongdoing.

As a preface, federal and state law impose a number of legal duties designed to keep the banking system functioning smoothly to foster customer confidence. First, banks must process their customers' transactions. *See, e.g., Stowell v. Cloquet Co-op Credit Union*, 557 N.W.2d 567, 575 (Minn. 1997); *Farmers State Bank v. Sig Ellingson & Co.*, 16 N.W.2d 319, 324 (Minn. 1944) ("The bank's obligation is to pay the checks drawn on the depositor's credit."); Minn. Stat. § 336.4-402(a)) (imposing strict liability on banks for wrongfully dishonoring a check). Second, in carrying out that obligation, banks must act promptly. *See e.g.,* Minn. Stat. §§ 336.3-103(a)(9), 336.4-302(a)(1) (banks must timely pay demands); 12 C.F.R. §§ 229.30, 229.38(b) (strict deadline for returning checks). Third, a bank is responsible for keeping customer information confidential. 15 U.S.C. § 6802(a).

To meet these obligations on a timely basis, "a bank cannot be expected to track transactions in fiduciary accounts or to intervene in suspicious activities." *Chazen v. Centennial Bank*, 71 Cal. Rptr. 2d 462, 465-66 (Ct. App. 1998). Thus, under Minnesota law, a bank owes no duty to investigate a customer's suspicious behavior. *See, e.g., Swift Cnty. Bank v. United Farmers Elevators*, 366 N.W.2d 606, 609 (Minn. Ct. App. 1985) ("We cannot say that a bank ought, much less that it has a duty, to inquire minutely into the affairs of the depositor's checking account.").

Courts in Minnesota (and throughout the nation) thus strictly curtail the instances in which banks can be held liable for aiding and abetting a customer's fraud, requiring allegations of substantial assistance that go far beyond routine banking transactions and allegations of actual knowledge established by more than amalgamating red flags. *See Witzman*, 601 N.W.2d at 189. Such judicial rigor is precisely why the *Grad* lawsuit was dismissed. The Wisconsin courts concluded that investors, whose allegations were materially similar to the Receiver's, could not come close to pleading that Associated aided and abetted the Receivership Entities' fraud. *Grad*, 801 N.W.2d 349.

1. The Complaint fails to plead substantial assistance.

Substantial assistance "requires the plaintiff to show that the secondary party proximately caused the violation, or, in other words, that the encouragement or assistance was a substantial factor in causing the tort." *K&S P'ship v. Cont'l Bank, N.A.*, 952 F.2d 971, 979 (8th Cir. 1991); *cf. Chem-Age Indus., Inc. v. Glover*, 652 N.W.2d 756, 774-75 (S.D. 2002) (defendant must have "rendered 'substantial assistance' to the breach of duty, not merely to the person committing the breach") (citing *Witzman*). A party must have offered more than "the provision of routine professional services." *Witzman*, 601 N.W.2d at 189.

"[M]ere maintenance of a bank account, receipt or transfer of funds, or repeated execution of wire transfers involving allegedly purloined funds do not constitute substantial assistance." *El Camino Res.*, 722 F. Supp. 2d at 911 (citing *Weiss v. Nat'l Westminster Bank PLC*, 453 F. Supp. 2d 609, 621-22 (E.D.N.Y. 2006)). Were the law otherwise, "every bank would be an aider and abettor of every fraudulent customer, merely on the theory that the customer needed access to bank accounts to accomplish the fraud." *Id*. at 928.

Allegations of suspicious account activity do not lower the threshold for pleading substantial assistance: "The caselaw is clear that opening accounts and approving transfers, even where there is a suspicion of fraudulent activity, does not amount to substantial assistance." *In re Agape Litig.*, 681 F. Supp. 2d 352, 365 (E.D.N.Y. 2010). Nor does a bank's inaction in light of suspicious activity—"*e.g.*, failing to shut down the accounts sooner or to inform the plaintiffs about the suspected fraud"—"rise to the level of substantial assistance." *Ryan v. Hunton & Williams*, 2000 WL 1375265, at *10 (E.D.N.Y. 2000). *See also Rosner v. Bank of China*, 2008 WL 5416380, at *14 (S.D.N.Y. 2008) (bank's failure "to comply with domestic and international bank secrecy, know-your-customer, and anti-money laundering laws" "do[es] not elevate [a bank's] actions into the realm of 'substantial assistance'"), *aff'd,* 349 F. App'x 637 (2d Cir. 2009).

Nothing in the Complaint comes close to alleging that Associated substantially assisted the fraud. The Receiver asserts that Associated allegedly [redacted] But these are prototypical routine banking services.

The Receiver argues that Associated provided these services despite suspicious activity or red flags, but that cannot elevate Associated's routine banking services into "substantial assistance." Such allegations are consistently dismissed as insufficient to hold a bank liable for aiding and abetting a Ponzi scheme. For example, in *In re Agape Litigation*, Cosmos used accounts at Bank of America ("BOA") to run a phony investment scheme. The allegations against BOA were extensive:

- "BOA effectively established an unofficial branch within Agape headquarters … to provide on-site banking services." 681 F. Supp. 2d at 358.
- "The BOA employee staffed to Agape's headquarters had access to Agape's business records and personal contact with Agape employees." *Id.* at 362.
- There were several "'red flags' or badges of fraud that should have induced BOA" to investigate the fraudsters, including that "investor deposits" were used for "(1) significant wire transfers totaling $100 million or more; (2) personal payments to [the fraudster]; (3) interest payments to certain investors; and (4) payments to brokers." *Id.* at 358-59.

- The fraudster "commingled these investors funds without segregating the money according to investor name" and used the "operating account" meant to fund investments "to wire funds to Panama and Switzerland." *Id.* at 358.

- "[W]hen a particular investor sought a redemption, it was the BOA employee—at Cosmo's direction—who issued the investor a check for $162,500." *Id.* at 362.

- There was "a conversation between the BOA employee and an unnamed broker in which the BOA employee apparently failed to correct the broker's misapprehension that the loan Agape was waiting for from BOA was for $1 million and not $28 million as the broker had been told by Cosmo." *Id.*

Although BOA continued to provide banking services to Cosmos, the court dismissed aiding and abetting claims because "opening accounts and approving transfers, even where there is a suspicion of fraudulent activity, does not amount to substantial assistance." *Id.* at 365. Moreover, because "BOA had no affirmative duty to detect and thwart Cosmo's fraud," BOA's "failure to act may not serve as the basis for claiming that the defendant provided substantial assistance." *Id.*

Similarly, in *Ryan*, Wolas used accounts at Chemical Bank to perpetuate an illegal scheme. 2000 WL 1375265, at *1. Chemical provided banking services to Wolas through May 1995, notwithstanding:

- Chemical "was on notice of various of 'red flags' that indicated fraudulent conduct by Wolas." *Id.*

- In May 1994, Chemical "declined to open" an account associated with Wolas because "Chemical's in-house fraud investigative unit[] suspected" that the account would be used for fraud. *Id.*

- In June 1994, Chemical learned that Wolas had over-billed Chemical's predecessor. *Id.*
- Later in 1994, Chemical closed some accounts maintained by Wolas because a large check bounced. *Id.*
- Wolas created an attorney escrow-account that had several suspicious transactions. *Id.* at *1-2.

Despite these suspicious flags—even Chemical's internal fraud team had rejected opening a related account—Chemical approved and continued to execute transactions. *Id.* at *2. But the court dismissed aiding-and-abetting claims against Chemical because "inaction, *e.g.*, failing to shut down the accounts sooner or to inform the plaintiffs about the suspected fraud … do[es] not rise to the level of substantial assistance." *Id.* at *10.

Agape and *Ryan* are typical of decisions across the country. Numerous other courts have dismissed aiding and abetting claims in like circumstances. *See*, *e.g.*, *Weshnak v. Bank of Am. N.A.*, 451 F. App'x 61, 61-62 (2d Cir. 2012); *Lawrence v. Bank of Am., N.A.*, 455 F. App'x 904, 907 (11th Cir. 2012); *Groom v. Bank of Am.*, 2012 WL 50250, at *4 (M.D. Fla. 2012); *In re Section 1031 Exch. Litig.*, 716 F. Supp. 2d 415, 427 (D.S.C. 2010); *Stern v. Charles Schwab & Co.*, 2009 WL 3352408, at *8-9 (D. Ariz. 2009); *In re Consol. Meridian Funds*, 485 B.R. 604, 625 (Bankr. W.D. Wash. 2013); *Go-Best Assets Ltd. v. Citizens Bank*, 972 N.E.2d 426, 437 (Mass. 2012). Permitting an aiding and abetting claim to proceed here would contravene this authority.

2. The Complaint fails to plead actual knowledge.

To state a claim for aiding and abetting another's tort, a complaint must allege that a party had "actual knowledge" of the tort. *Witzman*, 601 N.W.2d at 188. This requires "scienter—the defendants must know the conduct they are aiding and abetting is a tort." *Id.* at 186; *see also E-Shops Corp. v. US Bank Nat'l Ass'n*, 795 F. Supp. 2d 874, 877 (D. Minn. 2011) (Doty, J.) (requiring actual knowledge "that the primary actor's conduct constituted fraud"), *aff'd*, 678 F.3d 659 (8th Cir. 2012); *Christopher v. Hanson*, 2011 WL 2183286, at *11 (D. Minn. 2011) (requiring "actual knowledge"). In sum, "the universal rule requires actual knowledge of the tortious conduct by the wrongdoer, not merely that the defendant knew something was wrong in general." *El Camino Res.*, 722 F. Supp. 2d at 922. The Receiver entirely fails to meet this exacting standard.

Fraud and false representations (Claims I & IV). The Receiver expressly concedes not only that Associated was unaware of the Ponzi scheme, but that if Associated had been aware, Associated would have put an end to it: [redacted] This is the opposite of an allegation that Associated had actual knowledge of the fraud. The Wisconsin Court of Appeals considered a nearly identical allegation against Associated in *Grad* and held that it defeated plaintiffs' aiding-and-abetting claims, because it undercut any suggestion that Associated knew of the fraud:

> Grad's complaint does not allege that Associated intended to assist [a Receivership Entity] in breaching a fiduciary duty to Grad or converting his property. To the contrary, Grad's complaint alleges that, had Associated known about the fraud, it would have "[frozen] the accounts and immediately report[ed] the suspicious facts circumstances to law enforcement." … This allegation is inconsistent with a theory that Associated intended to assist [the Receivership Entity's] intentional torts.

Grad, 801 N.W.2d 349, at *7. The same logic applies with equal force here.

Beyond the Receiver's concession that Associated lacked actual knowledge, his allegations of what Associated actually knew are insufficient to show that Associated was aware of the underlying fraudulent activity. As we recounted (*supra*, at 6), the Receiver alleges that Associated knew that [redacted]

[redacted]

Even assuming on this motion to dismiss that these allegations are true, they support nothing more than an inference that Associated should have been *suspicious* that "something was wrong in general." *El Camino Res.*, 722 F. Supp. 2d at 922. They do not show that Associated actually *knew* a fraud was occurring. Absent allegations that Associated *actually knew* the principals were committing tortious acts, the Receiver cannot nudge his claim "across the line from conceivable to plausible." *Iqbal*, 556 U.S. at 680 (quotation omitted). Rather, "[b]ecause banks have no duty to investigate even suspicious transactions, allegations of such transactions do not demonstrate the actual knowledge required for aiding and abetting claims." *Perlman v. Wells Fargo Bank, N.A.*, 2012 WL 3289826, at *1 (S.D. Fla. 2012); *see also Stern v. Charles Schwab & Co.*, 2010 WL 1250732, at *9-13 (D. Ariz. 2010) ("suspicious activity does not satisfy the knowledge requirement of Arizona's aiding and abetting law"); *El Camino Res.*, 722 F. Supp. 2d at 922 ("mere 'suspicions,' even of tortious conduct, are insufficient to satisfy the actual knowledge standard").

Breach of fiduciary duty (Claim II). Likewise, nothing in the Complaint supports the naked assertion that Associated [redacted]

[redacted] But for the reasons discussed above, the Receiver does not provide any basis to conclude that Associated *actually knew* that Cook, Kiley and Pettengil were doing so. *See Groom*, 2012 WL 50250, at *3-4.

Conversion (Claim III). Again, the Receiver baldly asserts that [redacted] But that is simply a "formulaic recitation of [one of] the elements of [the Receiver's] cause of action" that the Court is not to accept as true, and should "set aside." *Braden*, 588 F.3d at 594. The facts that the Receiver pleads do not show that Associated actually knew that Cook, Kiley, and Pettengill's conduct constituted conversion. The Receiver, for example, complains that [redacted] Even assuming that allegation raises an inference that Cook and Kiley's conduct was suspicious, it does not demonstrate that the Bank *actually knew* Cook and Kiley were converting investment funds, or intended to do so. *See, e.g., Lenczycki v. Shearson Lehman Hutton, Inc.*, 656 N.Y.S.2d 609, 610 (App. Div. 1997) (affirming dismissal of aiding-and-abetting-conversion claim, absent evidence that the defendant money-management firm knew the primary tortfeasor "inten[ded] to convert the funds").

Courts faced with allegations nearly identical to those here routinely dismiss claims that a bank aided a Ponzi fraudster. *Agape* and *Ryan* (*see*, *supra*, at 22-24) both concluded that the extensive allegations of suspicious account activity and other signs of misconduct failed to show that a bank had actual knowledge. *See Agape*, 681 F. Supp. 2d at 364 (the several suspicious signals and red flags showed, at most "*constructive knowledge* of [the] scheme," not that the bank actually "recognized the fraud"); *Ryan*, 2000 WL 1375265, at *9 ("[a]llegations that [the bank] suspected fraudulent activity … do not raise an inference of actual knowledge of … fraud").

The Eleventh Circuit recently affirmed dismissal of a substantially similar claim. In *Lawrence*, 455 F. App'x at 905, Diamond operated a Ponzi scheme through accounts at Bank of America. BOA allegedly had several warning signs of misconduct:

- "Diamond made exceptionally large deposits into the Diamond Ventures account." *Id.*
- "[M]illions of dollars streamed out of the Diamond Ventures Account to fund personal and gambling expenditures for Diamond." *Id.*
- "Diamond engaged in atypical business transactions, such as numerous wire transfers unrelated to any legitimate business activity." *Id.*

- Diamond "informed Bank of America of his personal history and the nature of his business, which was an 'investment club.' Bank of America does not permit investment clubs." *Id*.

- "Account statements reflected that approximately $37,600,000 was deposited by 200 investors, and $15,400,000 was transferred from Diamond Ventures to foreign exchange companies. However, account statements did not indicate that Diamond profited from money transferred to foreign exchange companies. Nevertheless, Diamond sent investors 2,300 checks totaling more than $15,600,000. The Premier Banking Representatives, therefore, should have known that the money being sent to investors came from new client deposits, rather than profits from foreign exchange companies." *Id*.

But because Florida law (just like Minnesota law) "does not require banking institutions to investigate transactions," the Eleventh Circuit held that "such allegations are insufficient under Florida law to trigger liability" and affirmed the trial court's dismissal of the aiding-and-abetting claim. *Id*. at 907. Other courts have reached the same result. *See*, *e.g.*, *Stern*, 2010 WL 1250732, at *10-11; *In re Palm Beach Finance Partners, L.P.*, 2013 WL 1114356, at *8-10 (Bankr. S.D. Fla. 2013).

As with the Complaint's failure to plead substantial assistance, it would be nothing short of exceptional to find these allegations sufficient to plead actual knowledge.

At bottom, nothing here establishes that Associated actually knew of the illegal conduct. Banks "will always have more information about the client's conduct than the general public, making them vulnerable to the hindsight accusation that they knew of the client's wrongdoing or were wilfully blind." *El Camino Res.*, 722 F. Supp. 2d at 908. But courts must reject claims that would "make such institutions the guarantors of their customers' conduct." *Id*. As the Receiver's "factual narrative is, at best, merely a story of suspicious activity that Plaintiff contends should have provided Defendant notice of the ponzi scheme," the suit must be dismissed. *Litson-Gruenber v. JPMorgan Chase & Co.*, 2009 WL 4884426, at *3 (N.D. Tex. 2009).

B. Count IV duplicates Count I.

Count IV asserts a claim for aiding and abetting "false representation and omission." But "false representation" is simply the first element of common law fraud—the Receiver's first claim. *U.S. Bank N.A. v. Cold Spring Granite Co.*, 802 N.W.2d 363, 373 (Minn. 2011); *Hoyt Props., Inc. v. Prod. Res. Grp., L.L.C.*, 736 N.W.2d 313, 318 (Minn. 2007). Because Count IV is subsumed by Count I, it should be dismissed.

CONCLUSION

The Court should dismiss the Complaint.

Respectfully submitted,

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