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, v. ASSOCIATED BANK, N.A., Defendant.	)	CIVIL ACTION File No.: 13-cv-00232 (DSD-JSM)

THE RECEIVER'S MEMORANDUM IN OPPOSITION
TO ASSOCIATED BANK'S MOTION TO DISMISS

I. INTRODUCTION AND PROCEDURAL BACKGROUND

Associated Bank ("the Bank") departed from standard banking practices. The Bank lent direct aid to the Cook/Kiley Ponzi Scheme ("the Scheme"). The Bank benefited by having custody and use of ill-gotten millions sitting in non-interest-bearing accounts. (Compl. ¶ 52). Discovery will likely show additional benefits for the Bank from the Scheme. In the Scheme's heyday, 2007-2009, credit markets had frozen, stress tests were underway, and financial institution liquidity and balance sheet health meant the difference between profitability and FDIC-takeover.

The Receiver identified many of the Bank's atypical acts in its well-documented and detailed Complaint. The Bank aided the Scheme in numerous ways. For example, the Bank advised the Scheme on how to create and mask

accounts to avoid detection under the Bank Secrecy Act / Anti-Money Laundering Act ("BSA/AML"). The Bank opened and maintained the main account of the Scheme (the "Crown Forex LLC" account) without confirming that its putative owning entity even existed, and then lied on account documents that the Bank had complied with the requirements of the Patriot Act. Bank officers personally visited the Scheme's place of business – a private residence in a suburban neighborhood – and yet knowingly named a commercial address instead. The Bank allowed Crown Forex checks to issue that misstate the issuer as "Associated Bank" and prepared false cashier's checks to lend an aura of legitimacy to mollify the Scheme's victims. The false checks totalled more than $3.2 million and appeared to issue from the individual that was identified as the payee, or from an IRA or other account in the name of the payee. (Compl. ¶ 64; *see*, *e.g.*, Compl. Ex. 34). This action of the Bank created the illusion that the investors' funds were coming from individually segregated accounts, and not the co-mingled account at the Bank from which the funds were actually being remitted. The Bank even, at one point, allowed the Scheme's mastermind to walk off with $600,000 cash in a box. The Bank knew that the funds were for the personal purpose of buying a yacht, but with the endorsement of the "Security and Crime Prevention Department," took extra pains to source the funds from an account that the Bank knew held investor moneys. To make things worse, the Bank collaborated with the Scheme's agents to delay enhanced scrutiny from federal banking authorities, deliberately forestalling the Scheme's discovery.

All of these acts transcend any characterization as the innocent mistake of missing a few "red flags." The Bank's acts depart from federal and state banking requirements, from the Bank's own procedures and policies, and from common sense. The Complaint includes these and many more well-pleaded allegations, adequately pleading various aiding and abetting torts.

Having once helped deprive Minnesota and other investors of their life savings, the Bank then deprived them of their remedy in the courts of Wisconsin. It now seeks to foreclose any remedy by any party. After the Scheme unraveled, the Wisconsin Court of Appeals, in a 2-1 decision with a sharp dissent, accepted the Bank's rationale that it was not directly liable to the Scheme's most visible victims – the investors. *See generally Grad v. Associated Bank*, 801 N.W.2d 349, 2011 Wisc. App. LEXIS 449 (Wisc. App. 2011). They had no banking customer relationship, so the duty of care did not reach to them. *Id.*

Now that the court system has blockaded investor claims against the Bank, the Receiver brings this action. The Wisconsin court's rationale does not apply to the Receiver. Unlike the more indirect victims of the Scheme, the Receiver stands in the shoes of actual Bank customers – the Receivership Entities. Yet with no small dose of irony, the Bank now seeks a Rule 12(b)(6) dismissal. In its motion, the Bank now states that the *investors* are the proper plaintiffs to bring this case. (Bank Mem. 13-16). The Court should not let the Bank have it both ways.

As explained below, all of the asserted grounds for dismissal lack merit. The equitable defense of *in pari delicto* does not apply. *Res judicata* does not

exist. The Receiver has proper standing. And the Complaint amply states claims for which relief can be granted. The Bank's motion to dismiss should be denied.

II. FACTUAL BACKGROUND

Chief Judge Davis appointed the Receiver "for the purpose of marshalling, preserving, accounting for and liquidating the assets" of the Receiver Estates. (Case No. 09-cv-3332 (D. Minn.), Dkt. No. 96, at 3). Among the powers of the Receiver are to "[i]nitiate, defend, compromise, adjust, intervene in, dispose of, or become a party to any actions or proceedings in state, federal or foreign jurisdictions necessary to preserve or increase the assets of the Defendants or to carry out his or her duties pursuant to this Order." (*Id.* at 4; *see also* Case No. 09-CV-3333 (D. Minn.), Dkt. No 68, at 3, granting Receiver "full power to sue [] and recover . . . rights, credits, moneys . . . of the Receiver Estates"; Case No. 11-cv-574 (D. Minn.), Dkt. No. 10, at 2-3, same).

The Bank agrees that the Receiver "may assert claims" that the Receivership Entities possess. (Bank Mem. 7). This, of course, tracks the holdings of other sister courts that had the occasion to address the scope of the Receiver's powers. *See, e.g., Zayed v. Buysse, et al.*, No. 11-cv-1042 (D. Minn.); *Zayed v. Kabarec*, No. 11-cv-1104 (D. Minn.); *Zayed v. NRP Financial, Inc.*, No. 12-cv-35 (D. Minn.); *Zayed v. Peregrine Financial Group, Inc.*, No. 12-cv-269 (D. Minn.). Yet, now, contrary to well-established authority, the Bank urges this Court to to tie the Receiver's hands and prevent this action from moving forward.

The Bank also claims that the Receiver has failed to allege sufficient facts to state a claim. Section III.D., below, sets out the numerous factual allegations of the 47-page, 98-paragraph Complaint that refute the Bank's argument that the Complaint fails to state a claim. In brief summary here, with the prize of interest-free deposits in mind (Compl. ¶ 52), the Bank masked the true nature of the Scheme's accounts to avoid detection under various banking laws by falsifying account documents (Compl. ¶¶ 5, 13, 37-38, 44, and 61) and to varnish the accounts with an aura of legitimacy that induced the investors to invest in the Scheme. (Compl. ¶ 9). Moreover, the Bank actively participated in the embezzlement of the illegally obtained investor funds for the fraudsters' own financial gain. (Compl. ¶¶ 10, 11, 53-56 and 60).

The Bank was party to, or witness to, an unusual pattern of events intimating an illegal scheme. This evidence includes suspicious deposits and wire transfers in the millions and tens-of-millions, sometimes broken up into pieces (Compl. ¶¶ 47-48, 51, 59, 65 and 67-68), the opening of a string of similarly named Oxford accounts (Compl. ¶ 49), ignoring warnings of suspicious activity raised internally within the Bank by the monitoring department and other Bank employees (Compl. ¶¶ 12, 57 and 63), depleting funds from known investor accounts into known fraudster personal accounts (Compl. ¶¶ 49-65), and ignoring public information indicating that Crown Forex LLC and Crown Forex, SA were scams (Compl. ¶¶ 58 and 66). This is all, of course, after the Bank aided and abetted the Scheme by opening the Crown Forex LLC account by subverting

BSA/AML regulations (Compl. ¶¶ 5,13 and 37-38). Taken together, this evidence is more than enough to establish a plausible inference that the Bank aided and abetted the Ponzi scheme.

In his dissent from the decision depriving the investors of a negligence claim under Wisconsin law, Judge Brunner observed:

> If Grad's allegations are true, the Crown Forex account was so obviously fraudulent that, had Associated Bank bothered to look, it would have discovered the sham and prevented the misappropriation of millions of dollars. The court today concludes that, despite numerous federal banking regulations requiring Associated Bank to know its customers and what they are up to, the bank has no affirmative duty to investigate its customers' potential fraud.
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> * * *
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> Given the public concern for protecting investors and the stability of our financial system, I cannot conceive of a case in which public policy is more supportive of allowing a third party to proceed against financial institutions for their negligent failure to follow banking laws.

Grad, 2011 Wisc. App. LEXIS 449, at *23, *36. What is now known that even Judge Brunner did not know is that the Bank did much more than not "bother to look." It actively participated. The Bank falsified account documents for fictitious entities. The Bank provided advice on how to avoid detection under the BSA/AML. The Bank falsely stated that it had complied with the requirements of the Patriot Act. And, the Bank illegally transferred millions in investor funds to Cook's private accounts.

Thus, the well-pleaded facts establish the Bank's deep entanglement with the Scheme. Bank officers were directly involved in the Scheme, at multiple levels, and the Bank directly benefited from the Scheme.

III. ARGUMENT

A. *IN PARI DELICTO* DOES NOT BAR THIS ACTION

Despite the fact-bound and equitable nature of the affirmative defense, the Bank first argues it is entitled to dismissal on the pleadings based on the *in pari delicto* doctrine. The Bank's arguments misunderstand this defense. None of the Bank's authorities involves a federal equity receiver asserting high-scienter torts against wrongdoers who directly participated in and benefited from a Ponzi scheme fraud.

1. The *In Pari Delicto* Doctrine Does Not Apply As a Matter of Law

i. Equity and Policy Considerations Foreclose the Defense

The doctrine of *in pari delicto* serves equitable and public policy purposes. Where investment fraud is involved, the Supreme Court cautioned that a court should only apply *in pari delicto* when "preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985). Minnesota law is in harmony. "A paramount public interest in the enforcement of some statutes may call for judicial intervention in favor of one wrongdoer against the other in order to effectuate the enforcement of a public

policy which overrides considerations of a benefit inuring to a wrongdoer." *State by Head v. Aamco Automatic Transmissions, Inc.*, 199 N.W.2d 444, 448 (Minn. 1972) (cited by the Bank). Thus, a court should not apply *in pari delicto* in situations where a "private right of action will be an ever-present threat to deter anyone contemplating [unlawful] business behavior. . . ." *Id.* (applying defense in government consumer protection suit only after confirming that no private right of action would be harmed).

These policy directives impel the Court not to preclude suit by the last private entity – the Receiver – with any reasonable chance of holding the Bank accountable for its wrongful actions. Such a bar would be the death of equity. No party would remain who might recover from the Bank for its part in the Scheme.

ii. Case Law Forecloses the Defense

Not surprisingly, the Bank unearthed no authority on point. The Bank relies heavily on cases applying *in pari delicto* to bar suits by bankruptcy trustees (*e.g.*, Bank Mem. 8-9, citing *Grassmueck v. Am. Shorthorn Ass'n*, 402 F.3d 833 (8th Cir. 2005); *Peterson v. Winston & Strawn, LLP*, 2012 WL 4892758 (N.D. Ill. 2012); and *Christians v. Grant Thornton, LLP*, 733 N.W.2 803 (Minn. App. 2007)). The Bank calls *Christians* "particularly instructive," stating that a bankruptcy trustee like the one in *Christians* is "a position akin to the Receiver." (Bank Mem. 9). The Bank could not be more wrong.

While both bankruptcy trustees and receivers are court-supervised persons who replace the original management of an entity during court proceedings, the

comparison ends there. The powers and reach of a receiver are significantly different from, and broader than, those of a bankruptcy trustee. The Bankruptcy Code hard-codes by statute that a trustee stands in the exact same shoes as the debtor as of the filing of a petition in bankruptcy, with no exceptions. No such statutory provision applies to federal equity receivers.

The Fifth Circuit recently underscored why bankruptcy trustees and receivers get different treatment under *in pari delicto*. *See Jones v. Wells Fargo Bank, N.A.*, 666 F.3d 955, 965-68 (5th Cir. 2012). Describing the decisions barring relief by a bankruptcy trustee as "plainly distinguishable," the *Jones* court declined to port over *in pari delicto* principles to a receiver bringing a tort action against a bank. *Id.* at 968. This was because bankruptcy trustee powers are defined under Section 541(a) of the Bankruptcy Code, "which limits the debtor estate to interest of the debtor as of the commencement of the case." *Id.* (internal quotation omitted) (citing numerous cases distinguishing bankruptcy trustees from receivers to allow suit over *in pari delicto* defense). In contrast, the powers of receiverships are determined under state law. *Id.* at 966 n.11 (citing *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 83 (1994)). Thus, by federal statute, a trustee is considered to be the same "wrongdoer" for all purposes as the bankrupt entity, and would be bound, no exceptions, by all defenses assertable against such an entity. *Id.* But this principle will not necessarily apply to receivers.

In allowing the receivership's tort claims against the bank, *Jones* followed the Seventh Circuit's reasoning in *Scholes v. Lehman*, 56 F.3d 750, 754-55 (7th

Cir. 1995). *Scholes* noted that the defense of *in pari delicto* "loses its sting when the person who is in pari delicto is eliminated." *Id.* at 754.[1] In effect, the appointment of a receiver liberates the corporate entity from its status as an "evil zombie" of the wrongdoer management, reversing the equities of an otherwise-applicable defense. *Id.* Minnesota law is in accord with *Scholes*. "[W]hen an act has been done in fraud of the rights of the creditors of the insolvent corporation, the receiver may sue for their benefit, even though the defense set up might be valid as against the corporation itself." *German-American Finance Corp. v. Merchants & Manufacturers' State Bank of Minneapolis*, 225 N.W. 891, 893 (Minn. 1929).[2] This District Court, in a case the Bank itself cites, adopted the reasoning in *Scholes* for federal equity receivers. *Kelley v. College of St. Benedict*, No. 12-cv-822, 2012 U.S. Dist. LEXIS 153802, at *13-14 (D. Minn. Oct. 26, 2012) (citing *Scholes* for proposition that "when a receiver has been appointed for a corporation, the wrongdoer (the corporation) is removed from the picture and, hence, *in pari delicto* does not apply," so that a "receiver is not precluded from

[1] The Bank argues that *Peterson v. McGladrewy & Pullen, LLP*, 676 F.3d 594, 599 (7th Cir. 2012) labeled this quotation from *Scholes* as dictum. The next sentence in *Peterson* that the Bank conspicuously fails to quote states, "It has nothing to do with §541 of the Bankruptcy Code; *Scholes* was not a bankruptcy proceeding." Thus, *Peterson* observed unremarkably that this quotation from *Scholes* was inapposite to bankruptcy trustee actions.

[2] The Bank incorrectly argues that *German-American* is limited to the fraudulent conveyance context. (Bank Mem. 12). The Bank is wrong. *German-American* did not concern a fraudulent transfer, but rather (like here) fraudulent bank recordkeeping calculated to mislead bank examiners and others about the nature of certain accounts. *Id.* at 534-35 (an "undisclosed agreement" not to collect on notes placed onto the bank's balance sheet).

asserting claims that would be barred by a corporation's own fraud had the corporation brought the claims on its own behalf.").

Jones also distinguishes another case cited by the Bank: *Knauer v. Jonathon Roberts Financial Group, Inc.*, 348 F.3d 230 (7th Cir. 2003). Like the unsuccessful defendant in *Jones*, the Bank argues that *Knauer* limited the earlier *Scholes* decision to preclusion of the defense against receivers asserting anything other than fraudulent transfer actions. (See Bank Mem. 11 n.2). However, *Knauer* did not distinguish *Scholes* with such a broad brush. *Knauer* allowed *in pari delicto* to succeed against a receiver who brought claims based just on the *relationship* with the defendants (*i.e.*, *respondeat superior* liability for the acts of, and failure to supervise, Ponzi-scheming employees). *Id.* at 237. But as *Jones* points out, *Knauer* "was decided under Indiana law, and reasoned that the equities of that case favored application of *in pari delicto* because the defendants were neither directly involved in the embezzlements at issue nor benefited from them." *Jones*, 666 F.3d at 968 n.12 (citing *Knauer*, 348 F.3d at 236-37). Here, the Receiver alleges the very direct involvement and benefit that both *Jones* and *Knauer* distinguish from the facts that controlled the outcome in *Knauer*.[3]

[3] District courts of the Seventh Circuit also limit *Knauer* to its facts, and do not allow the *in pari delicto* defense to bar tort claims by receivers that assert defendant involvement in and benefit from the wrongdoing. *Central Comm'y Church of God v. Ent & Imler CPA Group, PC*, No. 03-cv-678, 2004 U.S. Dist. LEXIS 24339, at *30-31 (S.D. Ind. Nov. 24, 2004) (finding equitable alignment resembles *Scholes* "more closely than *Knauer*" because the receiver "alleged that Ent & Imler was directly involved in CEG's frauduent misrepresentations to noteholders by recklessly ignoring and perpetuating those misrepresentations.");

The Bank's other cases are equally inapposite. The Bank relies on *Dickson v. Kittson*,[4] 77 N.W. 820, 821 (Minn. 1899), to counter the holding in *German-American* (quoted above) that receivers liberate corporations from the fraud of their wrongdoers. The Bank quotes *Dickson* to argue that "the Minnesota rule [is] that a receiver stands 'in the shoes' of the receivership entities and thus is bound by any defenses that would apply to them." (Bank Mem. 10). The Bank misreads *Dickson*. While a receiver was a party in that case, the carryover of defenses applied between an assignee-for-the-benefit-of-creditors and the relevant assignor – *not* because a receiver coincidentally stepped in. *Id.* ("[A]n assignee for the benefit of creditors stands in no better position than his assignor, and what would be a defense against the latter will be a good defense against the former . . . ."). The Bank also cites two noncontrolling South Carolina decisions – *Myatt v. RHBT Financial Corporation*, 370 S.C. 391 (S.C. App. 2007), and *Hays v. Pearlman*, No. 10-cv-1135, 2010 WL 4510956 (D.S.C. Nov. 2, 2010) (Bank Mem. 11-12). Each of these decisions applies *Knauer* because of the omission that *Jones* noted must exist for *Knauer* to apply – no allegation of direct involvement in and benefit from the fraud.

Baker O'Neal Holdings, Inc. v. Ernst & Young LLP, No. 03-cv-132, 2004 U.S. Dist. LEXIS 6277, at *25-26 (S.D. Ind. Mar. 24, 2004) (distinguishing *Knauer* and holding *Scholes* applicable because "the plaintiffs have alleged that Roach (and thus Ernst & Young) were *directly* involved in O'Neal's wrongdoing."). If this Court finds *Knauer* persuasive in any way, the Court should simultaneously follow the district courts of the Seventh Circuit, the circuit where *Knauer* has controlling force. Those courts distinguish *Knauer* from the types of facts the Complaint alleges here.

[4] Referred to by the Bank as *Dickson v. Baker*.

Thus, the Bank's *in pari delicto* defense fails as a matter of law. The Bank incorrectly applies bankruptcy trustee cases to a receivership, fails to recognize the liberating qualities of receiverships under Minnesota law, and fails to address the factual distinctions (direct participation and benefit) that remove this case from the scope of its cited authority.

2. The *In Pari Delicto* Doctrine Should Not Apply on the Pleadings

Even if the Court found some merit in the Bank's *in pari delicto* argument, it should defer ruling on the defense. Since it involves the Court's equitable consideration – including the level and amount of wrong perpetrated by the defendant compared to the pre-receivership plaintiff – courts generally do not consider the defense on a motion to dismiss. *In re Student Finance Corp.*, No. 02-cv-11620, 2006 U.S. Dist. LEXIS 56759, at *6 (Bankr. D. Del. Aug. 10, 2006) (denying motion because discovery needed to determine if ostensibly-independent accountant should be construed as corporate insider); *In re Oakwood Home Corp.*, 340 B.R. 510, 536 (Bankr. D. Del. 2006). Here, under the Complaint's allegations, the Bank's own wrongdoing (including setting up an account in the name of a fictitious company to avoid scrutiny) led to at least $70 million of fraudulent investment. Tellingly, the majority of the Bank's cited cases on *in pari delicto* were decided on summary judgment or at trial, not on the pleadings:

> The resolution of the in pari delicto defense requires the Court to engage in "an essentially equitable and necessarily factbound apportionment of responsibility" among Mr. Meisner, the Debtor, and other insiders of the Debtor. *Pearlman v. Alexis*, 2009 WL

> 3161830, 2009 U.S. Dist. LEXIS 88546 (S.D.Fla. Sept. 25, 2009). It is not appropriate to engage in such an analysis at this stage of the litigation.

In re Phoenix Diversified Inv. Corp., 439 B.R. 231, 243 (Bankr. S.D. Fla. 2010).

As with *In re Student Finance Corp* and *In re Phoenix Diversified Inv. Corp*, discovery may show that one of the main perpetrators within the Bank – Vice President Lien Sarles – was in fact (at least constructively) a corporate insider with the Receivership Entities. What makes this more plausible is that Vice President Sarles (as alleged in the Complaint ¶ 34) is a brother of one of the mastermind's employees. At a minimum, the Bank's deep entanglement with the fraud, and that of its officers, merits discovery before the Court entertains the *in pari delicto* defense.

B. *RES JUDICATA* DOES NOT APPLY

The Bank next fails to support the application of *res judicata*. The Bank argues that the failure of certain investors in the Wisconsin action to plead a viable cause of action bars the Receiver from doing so. The Bank thus argues inconsistently. On the one hand, it argues that the investors should be the ones who sue because the Receiver and the investors are distinct entities. But when the investors fail in their suit (as certain ones did in the Wisconsin action), the Receiver should be barred from proceeding based on the Bank's allegation of "privity." Such a "heads I win, tails you lose" argument lacks merit. In a Ponzi scheme case, a "judgment on the merits in one investor action would have no collateral estoppel effect on any investor (or the Receiver) who was not a party to

that action." *Commod. Fut. Trading Comm'n v. Chilcott Portfolio Mgmt.*, 713 F.2d 1477, 1486 (10th Cir. 1983). The Bank cites no authority to the contrary.

The Bank's cited cases fail to call into question the Receiver's lack of privity with prior investor-claimants. In *Reil v. Benjamin*, 584 N.W.2d 442 (Minn. App. 1998), Reil's employer brought a subrogation action alleging negligence against a party who had injured Reil in a car accident. When Reil tried to sue on his own behalf, he was found to be in privity with his employer. The Court held that "privity requires that the estopped party's interests have been sufficiently represented in the first action so that the application of collateral estoppel is not inequitable." *Id.* at 445. Reil and his employer met the requirements of privity for numerous reasons, paramount of which was that "Reil took the witness stand in the subrogation case and gave sworn testimony regarding the facts surrounding the accident," "took steps toward consolidating his case with [his employer's]," and "operat[ed] under the same legal theory – negligence – on which issue the jury made a determination." *Id.* The *Reil* court distinguished a prior case that found a lack of privity on the ground that the prior case involved parties who "had no right to be heard at oral argument" and "did not have any control over the proceedings." *Id.*

Here, no privity attaches because the Receiver had no control over, no right to be heard in, and no participation in the prior investor lawsuit. Nor is the Receiver asserting complete identity of legal theories, since the investors asserted pure negligence and an aiding an abetting claim based on intentional conduct,

whereas the Receiver asserts four distinct aiding and abetting torts based on "knowing" conduct. *Compare Grad*, 801 N.W.2d at 349-52 with Complaint ¶¶ 70-98.

The Bank illogically supports its privity argument by advancing the converse proposition – that if the Receiver wins *this* case, then the Scheme's Ponzi investors would be found in privity with the Receiver. Not only is this proposition irrelevant to proving the Receiver's privity with outcomes reached by *prior suing investors*, it is also both unripe and incorrect. *See Chilcott*, 713 F.2d at 1486. The Bank's cited case (*Lamson v. Towle-Jamieson Inv. Co.*, 245 N.W. 627 (Minn. 1932)) involved a receiver who expressly represented the interests of a creditor, making a later party who "as a creditor [] now claims" a right against the same defendant in privity with the receiver. *Id.* at 628. Likewise, the Bank's other authority fails to support its creditors-in-privity-with-the-Receiver argument (*i.e.*, the converse of the question actually presented by the Bank's motion): *Britt v. Vernon*, No. 06-cv-1358, 2006 U.S. Dist. LEXIS 75128 (E.D. Cal. Oct. 2, 2006). In *Britt*, the court found that the later-barred party was in privity with a litigating receiver because it had provided affidavits and live testimony in support of the receiver, was the only creditor named in the receiver's complaint, and the settlement by the court was approved on condition that the later party be named a creditor of the receivership. *Id.* at *21-22. None of these factors remotely applies here.

C. THE RECEIVER HAS STANDING

The Bank also fails to support its argument that the Receiver lacks standing. This Court has already held that the Receiver has standing to pursue claims on behalf of the Receivership Entities, even if those claims ultimately benefit investors. "In a Ponzi scheme, the entities used to further the fraud, in whatever corporate form, are instrumentalities of the scheme but they are also victims of the scheme." *Zayed v. Buysse*, No. 11-cv-1042, 2011 U.S. Dist. LEXIS 59068, at *11 (D. Minn. June 1, 2011); *Zayed v. Peregrine Financial Group, Inc.*, No. 12-cv-269, Doc. 30 at 5-6 (D. Minn. June 22, 2012) ("Because this case involves a Ponzi scheme, the Receivership Entities are considered victims of the fraud and thus creditors of the Ponzi scheme.").

The Bank's argument to the contrary rests on the incorrect assumption (refuted above in Section III.B.) that *investors* would have no future claim based on the *Receiver's* participation in this lawsuit, under principles of privity and *res judicata*. The Bank states, "[i]f the Receiver does litigate this case, it will likely have preclusive effect on the individual investors. (Bank Mem. 16). Permitting the Receiver to proceed would, accordingly, violate the 'deep rooted historical tradition that everyone should have his own day in court.'" (*Id*.). Calling this action "troubling" because the investors have no means to "opt-out," and analogizing a receivership action to class actions, the Bank states that the individual investors "should decide whether to sue and how to resolve that litigation – just as several investors have already done." (*Id*. at 16-17). This

statement is particularly ironic, since the Bank has already quashed one effort by investors to recover from it.

As much as the Receiver appreciates the Bank's welcome concern for the investors it helped defraud, this argument simply rehashes the *res judicata* argument. Critically, the Bank cites no authority that dismissed a federal equity receiver's tort suit against a Ponzi scheme aider-and-abetter on prudential standing grounds. A receiver has standing to bring claims against third parties where that claim belongs to the receivership entity (as the claims here do). *See Buysse*, 2011 U.S. Dist. LEXIS 59068, at *11-12; *see also Marion v. TDI Inc.*, 591 F.3d 137, 147-49 (3d. Cir. 2010). Even where the Receivership's claims on behalf of the receivership entity might replenish a fund for the benefit of investors' interests, that does not make the receiver's claims those of the investors, since "that is precisely the purpose of a receiver: to marshal the receivership entities' assets, to which several parties assert conflicting claims, so that the assets may be distributed to the injured parties in a manner the court deems equitable." *Wuliger v. Mfrs. Life Ins. co.*, 567 F.3d 787, 795 (6th Cir. 2009).

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In short, all three of the Bank's proposed legal bars to this lawsuit lack merit. The *in pari delicto* doctrine does not apply, or is unripe, for numerous reasons. The prior failed investors suit – far from precluding the ability of the Receiver to proceed on *res judicata* grounds – confirms that the Receiver may properly sue. Finally, prudential standing arguments simply rehash meritless *res*

judicata arguments, sprinkling them with feigned concern for the more than 700 investors who would like one day to recover their funds. If such a concern were sincere, the Bank would not have brought the present motion.

D. THE RECEIVER'S FACTUALLY DETAILED 47-PAGE 98-PARAGRAPH COMPLAINT STATES A CLAIM FOR RELIEF

Just as the Bank's asserted legal deficiencies fail scrutiny, the Bank's asserted pleading deficiencies also fail. The Complaint alleges facts with extraordinary particularity about the Bank's participation with, and benefit from, the Cook/Kiley Scheme. All four aiding and abetting counts adequately state a claim for which relief can be granted.

On a motion to dismiss, the Receiver's factual allegations are assumed to be true and all reasonable inferences from those allegations are drawn in favor of the Receiver. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009); *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 594 (8th Cir. 2009). To survive a motion to dismiss, the Receiver need only plead "enough facts to state a claim for relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). A claim has "facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 129 S. Ct. at 1949. While the Receiver may not rely on "labels and conclusions" or "a formulaic recitation of the elements of a cause of action," the Receiver "need not [provide] detailed factual allegations" in support of [his] claims, all that is required is sufficient factual information to establish that the

claim is "plausible" no matter how remote or unlikey an actual recovery may be. *Twombly*, 550 U.S. at 555.

The plausibility standard does ***not*** impose a "probability requirement," but "simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of [the claim]." *Twombly*, 550 U.S. at 556 (emphasis added). Nor does the Receiver need to explain away the Bank's claim that it was only providing "routine" banking services:

> Requiring a plaintiff to rule out every possible lawful explanation for the conduct he challenges would invert the principle that the complaint is construed most favorably to the nonmoving party, and would impose the sort of probability requirement at the pleading stage which *Iqbal* and *Twombly* explicitly reject.

Wal-Mart Stores, 588 F.3d at 597 (internal quotation marks and citations omitted).

The factually detailed, 47-page, 98-paragraph complaint goes well beyond a formulaic recitation of the elements of each claim. It alleges material facts supporting the conclusion that each claim is plausible, with a reasonable expectation that discovery will reveal evidence of the claims.

1. The Complaint States a Plausible Claim for Aiding and Abetting

To establish common law aiding and abetting, the Receiver must show that (1) a tort was committed causing injury, (2) that the Bank knew of the wrongdoing and, (3) the Bank substantially assisted the wrongful acts. *Am. Bank v. TD Bank, N.A.*, No. 09-cv-2240, 2011 U.S. Dist. LEXIS 49646, at *21 (D. Minn. May 9, 2011). Here, the Bank does not dispute that the Ponzi scheme committed injurious

torts (nor can they). Instead, the Bank argues that the Complaint fails to establish the elements of knowledge and substantial assistance. (Bank Mem. 18-19). As to establishing these elements, the Court evaluates the elements in tandem – a greater showing of one element lowers the level of proof required for the other element. *Camp v. Dema*, 948 F.2d 455, 459 (8th Cir. 1991) (liability for aiding and abetting may be established by a strong showing of substantial assistance coupled with a minimal showing of knowledge); *Am. Bank*, 2011 U.S. Dist. LEXIS 49646, at *24 (a high level of knowledge lowers the level of substantial assistance required).

A "defendant's general awareness of its overall role in the primary violator's illegal scheme is sufficient knowledge for aiding and abetting liability." *K&S P'ship v. Cont'l Bank, N.A.*, 952 F.2d 971, 977 (8th Cir. 1991) (citing *FDIC v. First Interstate Bank of Des Moines, N.A.*, 885 F.2d 423, 429-31 (8th Cir. 1989)). Under Minnesota law, knowledge is a question of fact and it may be inferred from circumstantial evidence, including evidence such as conducting business in an atypical manner or lacking in business justification. *K&S P'ship*, 952 F.2d at 977-79; *Am. Bank*, 2011 U.S. Dist. LEXIS 49646, at *22-24.

Even "otherwise unremarkable events viewed together may suggest an unusual pattern of events intimating an illegal scheme." *K&S P'ship*, 952 F.2d at 979-80; *Metge v. Baehler*, 762 F.2d 621, 626 (8th Cir. 1985) ("Although the facts we have recounted here at length are unremarkable taken in isolation, we find that taken together, they present what should have been a jury issue on the question of aiding-and-abetting liability.") *See Arreola v. Bank Of Am., N.A.*, No. 11-cv-6237,

2012 U.S. Dist. LEXIS 144765, at *8-9 (C.D. Cal. Oct. 5, 2012) (ignoring red flags, among other things, is evidence of knowledge resulting in the denial of a motion to dismiss).

K&S P'ship and *Metge* squarely refute the Bank's two-pronged defense that 1) it could not have rendered substantial assistance since it was merely engaged in providing "routine" banking services and 2) a bank has no duty to investigate its customers' activities and, as a result, the numerous red flags cited by the Receiver cannot be considered by the Court.

The Bank asserts that:

> 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.

(Bank Mem. 20). Yet, the only Minnesota "courts" cited in support are *Witzman* and *Swift City Bank*. Neither supports the Bank. *Witzman* states that substantial assistance "means something more than the provision of routine professional services." 601 N.W.2d at 189. It makes no mention of red flags, so it necessarily cannot render them irrelevant as the Bank has argued. Even the Bank does not argue that ignoring red flags is a legitimate part of "routine professional services."

As to *Swift City Bank*, it holds that in the context of a negligence claim, a bank does not have a duty to investigate suspicious checking account behavior unless it has actual or constructive knowledge that the customer is intending to

wrongfully divert funds. 366 N.W.2d at 609-10. Constructive knowledge arises "where the primary tortfeasor's conduct is clearly tortious or illegal" and the defendant has an "in-depth relationship" with the tortfeasor. *Christopher v. Hanson*, No. 09-cv-3703, 2011 WL 2183286, at *11 (D. Minn. June 6, 2011) (*citing Witzman*, 601 N.W.2d at 188).

The remaining authority cited by the Bank is equally unsupportive. It analyzes aiding and abetting under the laws of other jurisdictions such as Wisconsin (*Grad*), New York (*Agape* and *Ryan*), and Florida (*Lawrence*). *Grad* in particular shows that Wisconsin law requires heightened scienter compared to Minnesota law ("intent" rather than "knowledge"). These authorities simply do not apply.

2. The Receiver Has Pled a Plausible Claim of Knowledge and Substantial Assistance

The Bank argues, as stated above, that it cannot incur any liability on the Receiver's claims since it was only providing "routine" banking services and it has no duty to investigate red flags. Yet, this is the exact type of circumstantial evidence Minnesota law allows a court to consider which, when viewed together, suggests an unusual pattern of events intimating an illegal scheme. This evidence includes suspicious deposits and wire transfers in the millions and tens-of-millions (often in pieces to mask the true volume transferred) (Compl. ¶¶ 47-48, 51, 59, 65 and 67-68), the opening of a string of similarly named Oxford accounts (Compl. ¶ 49), ignoring warnings of suspicious activity raised internally within the Bank by

the monitoring department and other Bank employees (Compl. ¶¶ 12, 57 and 63), and ignoring public information indicating that Crown Forex LLC and Crown Forex, SA were scams (Compl. ¶¶ 58 and 66). Taken together, this evidence supports a plausible inference that the Bank aided and abetted the Scheme.

Nor is liability premised solely on ignoring red flags. The Receiver has also pled additional facts establishing that the Bank engaged in overt, affirmative acts that assisted the Ponzi schemers in fraudulently obtaining tens-of-millions and then embezzling the ill-gotten gains. This evidence is summarized in Compl. ¶ 72 and includes the following:

> * Falsely stating on the account documentation for account #5601 that the business was located in an office suite. (Compl. ¶¶ 35-36)
>
> * Falsely stating on the account documentation for account #5601 that it was a "Checking/Money Market" account for use as a "GENERAL OPERATING ACCOUNT." (Compl. ¶ 36)
>
> * Intentionally omitting from the account documentation for account #5601 that Kiley was a financial advisor, working from home, and that the intended use of account #5601 was to hold investor funds. (Compl. ¶¶ 29 and 34-36)
>
> * Advising Shadi Swais, Cook and Kiley on how to avoid detection under the BSA/AML by recommending that an account in the name of the fictitious Crown Forex LLC be opened instead of the foreign domiciled Crown Forex, SA. (Compl. ¶¶ 4-5 and 38)
>
> * Falsely stating that it had complied with the Patriot Act for account #1705. (Compl. ¶ 7)
>
> * Knowingly opening the Crown Forex LLC account #1705 without proper documentation. (Compl. ¶ 6)

* Intentionally omitting from the account documentation for account #1705 that Kiley was a financial advisor, working from home, and that the intended use of account #1705 was to hold investor funds. (Compl. ¶ 39)

* Falsely stating on the account documentation for account #1705 that the business address was 5413 Nicollet Ave, Ste 14, Minneapolis. (Compl. ¶¶ 40-41)

* Falsely stating on the account documentation for account #1705 that it was a "Checking/Money Market" account. (Compl. ¶ 39)

* Falsely stating on the "DECLARATION OF NO WRITTEN OPERATING AGREEMENT" that Crown Forex LLC was a Minnesota LLC. (Compl. ¶ 42)

* Preparing false documentation that allowed the fraudsters to obtain the ODM equipment (on-site mass-deposit machines) needed to deposit millions in investor funds remotely. (Compl. ¶ 43)

* Illegally transferring millions in investor funds held in the fictitious Crown Forex LLC account #1705 to Cook's private accounts. (Compl. ¶¶ 10, 11, 53-56 and 60)

* Allowing Cook to walk off with $600,000 in cash of investor funds despite widespread suspicions, under the gaze of the "Security and Crime Prevention Department." (Compl. ¶ 11)

* Correcting Vice President Sarles' illegal transfer of $1.7 million of investor funds from the Crown Forex LLC account #1705 to Cook's private bank account. (Compl. ¶ 12)

* Falsifying information on over $3.2 million in cashier's checks. (Compl. ¶ 64)

* Knowingly allowing checks to issue from the Crown Forex LLC account #1705 that falsely identified the funds were from a "Client Disbursement Account." (Compl. ¶ 9)

* Knowingly allowing checks to issue from the Crown Forex LLC account #1705 that falsely indicated the issuer was Associated Bank. (Compl. ¶ 9)

* Falsely stating that it had complied with the Patriot Act for account #5214. (Compl. ¶ 61)

* Knowingly opening the Basel Group LLC account #5214 without proper documentation. (Compl. ¶ 61)

* Falsely stating on the account documentation for account #5214 that it was a "Checking/Money Market" account. (Compl. ¶ 61)

* Intentionally omitting from the account documentation for account #5214 that Kiley was a financial advisor, working from home, and that the intended use of account #5214 was to hold investor funds. (Compl. ¶ 62)

* Falsely stating on the account documentation for account #2356 that it was a "Checking/Money Market" account. (Compl. ¶ 49)

* Intentionally omitting from the account documentation for account #2356 that Cook was a financial advisor, and that the intended use of account #2356 was to hold investor funds. (Compl. ¶ 49)

* Illegally removing the owner from account #1812 and then transferring the funds therein to Cook's private account. (Compl. ¶ 50)

Creating false bank documents for fictitious entities, providing advice on how to avoid detection under the BSA/AML, falsely stating that it had complied with the requirements of the Patriot Act, creating checks that appear from "Associated Bank" rather than the Scheme's operating account, falsifying information on cashier's checks in order to create an appearance of legitimacy, and illegally transferring millions in investor funds to Cook's private accounts are not "routine" banking services. They are all atypical activities that utterly lacked any business justification. More to the point, they are activities that show actual knowledge of the Scheme and the Bank's efforts to substantially assist in keeping the Scheme hidden.

Nor were these atypical activities accidental. With the plump prize of massive non-interest bearing deposits in mind (Compl. ¶ 52), the Bank masked the true nature of the accounts to avoid detection under the BSA/AML (Compl. ¶¶ 5, 13, 37-38, 44, and 61) and to varnish the accounts with a layer of legitimacy that induced the investors to invest in the scheme. (Compl. ¶ 9). Moreover, the Bank actively participated in the embezzlement of the illegally obtained investor funds for the fraudsters' financial gain. (Compl. ¶¶ 10, 11, 53-56 and 60).

These facts establish a plausible claim of knowledge, especially when viewed in combination with the Bank intentionally ignoring the suspicious activity before it including BSA/AML red flags:[5]

> Gonzalez knew, at the very least, that the falsified Verification of Deposit forms [prepared by him] were being used in connection with fraudulent mortgage applications.
>
> Furthermore, the Complaint alleges that the bank itself, aside from Gonzalez's actions, ignored multiple "red flags," choosing instead to enjoy the benefits of its financial relationship with Rangel and his business entities. (Compl. ¶ 68.) Plaintiffs allege that the bank knew that Rangel's business accounts involved the receipt of investor funds, knew of the multiple internal "red flags" that Rangel's banking activities triggered, and knew that Rangel was transferring money from investor-funded accounts to Rangel's personal accounts in Mexico. (Compl. ¶¶ 66, 68.) A common-sense reading of these allegations, taken together, sufficiently establish, at this stage, that the bank had actual knowledge of Rangel's fraud.

Arreola, 2012 U.S. Dist. LEXIS 144765, at *8-9 (denying motion to dismiss).

[5] Despite the Bank's protests that Minnesota law imposes no duty to investigate its customers, the BSA/AML and Patriot Act does impose such duties. *See* 12 C.F.R. § 21.21; Section 326 of the USA PATRIOT Act. In fact, the Bank was sanctioned for its failure to investigate its cutomers pursuant to the requirements of the BSA/AML. (Compl. ¶ 69).

Nor does the complaint need to contain allegations that the Bank actually knew the principals were committing tortious acts. (Bank Mem. 27). Again, the atypical activities set forth in the Complaint suffice to set forth a plausible claim:

> The complaint asserts that the Banks knew Slatkin was committing fraud and was breaching his fiduciary duties to class members. . . . The complaint details the manner in which the Ponzi scheme operated, describes Slatkin's fraudulent transactions, and outlines the Banks' involvement in these activities. It alleges, in particular, that the Banks utilized atypical banking procedures to service Slatkin's accounts, raising an inference that they knew of the Ponzi scheme and sought to accommodate it by altering their normal ways of doing business. This supports the general allegations of knowledge. . . . *See Camp v. Dema*, 948 F.2d 455, 459 (8th Cir. 1991) ("A party who engages in atypical business transactions or actions which lack business justification may be found liable as an aider and abettor with minimal showing of knowledge," . . .); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975) ("Conversely, if the method or transaction is atypical or lacks business justification, it may be possible to infer the knowledge necessary for aiding and abetting liability"). *While it is true the complaint does not directly state that the Banks knew Slatkin was running a Ponzi scheme and stealing investor funds, this is the net effect of allegations that the Banks knew of Slatkin's "fraud," "actively participated" in the Ponzi scheme with knowledge of his "crimes" and accommodated him by using atypical banking procedures to service his accounts."*

Neilson v. Union Bank of Cal., N.A, 290 F.Supp.2d 1101, 1120-21 (C.D. Cal. 2003) (denying motion to dismiss) (emphasis added).

In addition, given the Bank's in-depth knowledge of the Ponzi scheme and the clear illegality of the Scheme, constructive knowledge may also be found. *See Witzman*, 601 N.W.2d at 188. The clear illegality of the Scheme is beyond dispute. In-depth knowledge arises from, among other things, the Bank advising the Scheme on how to circumvent BSA/AML detection through the use of fictitious

accounts, falsifying account documents, setting up numerous similarly named accounts, and illegally transferring millions in investor funds to Cook's personal accounts. Moreover, knowledge is also established by the Bank's willful blindness to the evidence before it. *See Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S.Ct. 2060, 2069-70 (2011) (applying the criminal concept of willful blindness to a civil action to establish knowledge).

The overt, affirmative acts pled by the Receiver are also lethal to the Bank's claim that it did not render substantial assistance. The Bank repeatedly claims it was merely providing "routine banking activities," and as a consequence, it could not have rendered substantial assistance. (Bank Mem. 20-25). Yet, no matter how often the Bank repeats this mantra, there was simply nothing "routine" about falsifying account documents, assisting the schemers to avoid detection under the BSA/AML, falsely stating it had complied with the Patriot Act, illegally transferring millions in investor funds to Cook's personal accounts, providing Cook with $600,000 in cash in investor funds for a yacht, falsely representing to investors that the Bank issued checks when they came from the Scheme's accounts, and ignoring the numerous red flags it had before it. Simply put, these overt acts of affirmative assistance – all of which are atypical and completely lack any business justification – support a plausible inference that the Bank rendered the requisite substantial assistance the Ponzi schemers needed to fraudulently obtain tens-of-millions and then embezzle the ill-gotten gains, thereby harming the Receiver Entities. *See Camp*, 948 F.2d at 459 ("A party who engages in atypical

transactions or actions which lacked business justification may be found liable as an aider and abettor with a minimal showing of knowledge.").

Moreover, this Court's holding in *Am. Bank v. TD Bank, N.A.*, No. 09-cv-2240, 2011 U.S. Dist. LEXIS 49646 (D. Minn. May 9, 2011), further demonstrates that the motion to dismiss should be denied. In denying a motion for summary judgment, the Court found that a genuine issue of material fact existed on the substantial assistance element when presented with facts demonstrating far less assistance than those presented here, especially when the high level of knowledge established by the atypical activities is taken into consideration:

> Finally, Mercantile violated many of its own internal policies with respect to Pearlman. Conducting business in an atypical way is evidence of knowledge. *Metz v. Unizan Bank, No. 5:05 CV 1510, 2008 U.S. Dist. LEXIS 37270, 2008 WL 2017574, *18 (N.D. Ohio May 7, 2008)* (holding that atypical banking procedures, such as disregarding requirements for corporate authorization statements and valid signature cards, was sufficient to infer knowledge by bank of depositor's fraud). With a high level of knowledge that Pearlman was engaging in fraud, a showing of a lower level of substantial assistance is sufficient for aiding and abetting liability. *Witzman, 601 N.W.2d at 188*. Therefore, a genuine issue of material fact exists regarding whether Mercantile provided substantial assistance to Pearlman. As genuine issues of material fact exist with respect to each element of American Bank's civil aiding and abetting claim, summary judgment for this claim is denied.

Am. Bank, 2011 U.S. Dist. LEXIS 49646, at *23-24.

For all these reasons, the Bank's motion to dismiss should be denied. The totality of the factual evidence set forth in the Complaint establishes that a plausible claim of aiding and abetting exists under Minnesota law.

IV. NEW ARGUMENTS IN REPLY WOULD BE IMPROPER

It would be improper for the Bank to raise new arguments in reply. *Swanda v. Choi*, No. 10-cv-970, 2012 U.S. Dist. LEXIS 126009, at *14 n.9 (D. Minn. Aug. 3, 2012). The local rule mandates likewise, stating that the "reply memorandum must not raise new grounds for relief or present matters that do not relate to the opposing party's response." D. Minn. LR 7.1(c)(3)(B). Thus if the Bank should do so, the Receiver respectfully requests that the Court not entertain them.

V. CONCLUSION

For all of the reasons above, the Receiver respectfully requests that the Court deny the Bank's motion to dismiss. No affirmative defense, no prior litigation outcome by investors, and no standing defect bars relief. Moreover, the Complaint states claims for which relief can be granted.

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Respectfully submitted,

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