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)

REPLY IN SUPPORT OF DEFENDANT'S MOTION TO DISMISS REGARDING IN PARI DELICTO AND RES JUDICATA

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Pursuant to this Court's Pretrial Scheduling Order (Phase I), dated April 13, 2015 [ECF No. 67], reproduced below are those portions of Defendant Associated Bank, N.A.'s previously filed Reply In Support of Defendant's Motion to Dismiss [ECF No. 44] that address Associated's *res judicata* and *in pari delicto* defenses.

* * *

The Receiver's opposition urges this Court to accept the implausible premise that Associated had actual knowledge of an ongoing, multi-million dollar fraud, and then deliberately chose to assist it. To be clear, the Receiver does not allege that Associated was negligent or reckless, but instead asserts "high-scienter torts." [ECF No. 69 at 7.] And Associated allegedly did this not for payments from the Ponzi schemers but merely to attract new deposits. (*Id.* at 1-2.)

The previous aiding-and-abetting suit against Associated is particularly instructive. The investors there, just like the Receiver here, alleged that, if Associated had known about this fraud, Associated would have prevented it. The trial court dismissed the lawsuit, and the Wisconsin Court of Appeals affirmed. Tellingly, the Receiver focuses on the *dissent* in *Grad*, and then only that portion of the dissent that discussed *negligence*. [ECF No. 69 at 6.] The Receiver disregards that the dissenting judge agreed with the majority's dis-

missal of the *aiding-and-abetting* claim. *Grad*, 801 N.W.2d 349, at *9 (Brunner, J., concurring in part; dissenting in part).

In any event, the fact remains that the Receiver is not the proper party to bring this suit. Under the most analogous Minnesota precedent, the *in pari delicto* doctrine bars his claims. As for *res judicata*, the Receiver seems to think that an investor can sue, lose, and then sue again through the proxy of a receiver. But that would turn *res judicata* on its head. And, because of prudential standing, the Receiver cannot displace the investors from pursuing their own claims.

Finally, given the volume of the Receiver's rhetoric, a few words about Associated's position are warranted. Contrary to the Receiver's suggestion that Associated is trying to have it "both ways" [ECF No. 69 at 3], there is nothing inconsistent about arguing (1) that the Receiver is an improper litigant and (2) that he, like the proper litigants before him, has failed to state a claim against Associated. And, although defrauded investors are deserving of sympathy, that does not justify imposing liability on a party not legally responsible. The Receiver's repeated criticism of Associated's decision to defend itself is misplaced.

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

The parties agree that Minnesota law controls the application of *in pari delicto*. Every indication demonstrates that a Minnesota court would dismiss

this suit. But, to the extent there is any doubt about Minnesota law, certification to the Minnesota Supreme Court is warranted. (*See* Def's. Memo. 13 n.4.) The Receiver does not oppose this suggestion.

A. Equity and public policy do not foreclose the in pari delicto defense.

The Receiver cites *State by Head v. AAMCO Automatic Transmissions*, 199 N.W.2d 444, 448 (Minn. 1972), for the proposition that, in certain circumstances, the *in pari delicto* doctrine may bend to public policy considerations. [ECF No. 69 at 7-8.] But *Head* did not hold that public policy concerns always trump the *in pari delicto* doctrine. Rather, *Head* noted that when a cause of action is brought under a particular statutory scheme, such as antitrust, public policy concerns animating the cause of action might alter the common law rule. Notably, *Head* affirmed the dismissal of the common law claims before it on *in pari delicto* grounds.

Similarly, *Christians v. Grant Thornton, LLP*, 733 N.W.2d 803, 814 (Minn. Ct. App. 2007), affirmed an *in pari delicto* bar to common-law claims brought by a bankruptcy trustee, declining to restrict the doctrine based upon arguments that applying "it would harm innocent creditors." Instead, the court held that "in pari delicto" may bar a claim "despite the inevitable harm to creditors." *Id.* That *Christians* arose in the context of a bankruptcy is not a distinction that matters. *Christians* looked to fundamental principles of *in*

pari delicto under Minnesota law, not to plaintiff's status as a bankruptcy trustee.

B. Precedent requires application of in pari delicto.

No Minnesota court has resolved whether *in pari delicto* applies to a federal receiver pursuing a third-party tort claim. There is, however, clear Minnesota law barring a bankruptcy trustee from doing so. *Christians*, 733 N.W.2d at 814. And while a receiver's duties are defined by state law [ECF No. 69 at 7-9], Minnesota law makes clear that a receiver's rights are no greater than the receivership entities. *Dickson v. Baker*, 77 N.W. 820, 821 (Minn. 1899);[1] *see also Merrill v. Zimmerman*, 188 N.W. 1019, 1022 (Minn. 1922) ("by virtue of his appointment" a "receiver stands" in the "shoes" of the receivership entity). The same is true of a bankruptcy trustee. [ECF No. 69 at 9.] Accordingly, under Minnesota law, there is no distinction between a bankruptcy trustee and a receiver for purposes of *in pari delicto*. *Christians* thus provides substantial guidance.

The best the Receiver can do in Minnesota is point to a pair of fraudulent conveyance cases—*German-Am. Fin. Corp. v. Merchs.' & Mfrs.' State*

[1] It is the Receiver who misreads *Dickson*. [ECF No. 69 at 12.] There were two relationships at issue there: (1) a creditor had assigned rights to an assignee, and then (2) the receiver "stood in the shoes" of the assignee. 77 N.W. at 821. A defense against a creditor applied to the receiver because it survived both (1) the assignor-assignee relationship *and* (2) the receiver-receivership relationship. The second point, which the Receiver overlooks, is at issue here.

Bank, 225 N.W. 891 (Minn. 1929),[2] and *Kelley v. Coll. of St. Benedict*, 2012 WL 5309501, at *4 (D. Minn. 2012). (As well as a Seventh Circuit fraudulent conveyance case, *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995)). But *in pari delicto* applies to fraudulent conveyance claims very differently than it does to third-party tort claims.[3] In *Knauer v. Jonathon Roberts Financial Group*, 348 F.3d 230, 236 (7th Cir. 2003), the Seventh Circuit explained that third-party tort claims "present[] a different equitable alignment" than fraudulent conveyance actions, because the receiver "is not seeking to recover the diverted funds from the beneficiaries of the diversions." It thus distinguished *Scholes* because "this is 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.* The same is true here: Associated derived no benefit from the wrongdoing; it is simply accused of being partly to blame. In these circumstances, *in pari delicto* applies to the Receiver.

As *Knauer* reveals, law outside Minnesota is relatively clear: *in pari delicto* applies to a federal receiver pursuing third-party tort claims. *Myatt*, for

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[2] The Receiver's argument that *German-American* is not a fraudulent conveyance case, is wrong. [ECF No. 69 at 10 n.2.] The claim by the receiver in *German-American* was that the bank inappropriately held collateral that the corporation had conveyed to it. 225 N.W. at 892-93. There was no tort claim against the bank.

[3] The Receiver did not respond to this argument from Associated Bank's opening brief. (Def's. Memo. at 11 n.2.)

example, is *identical* to the circumstances here. There, a fraudster used accounts at the bank in conducting an illegal scheme, and a federal receiver brought aiding-and-abetting claims. 635 S.E.2d at 546. The court, following *Knauer*, concluded that *in pari delicto* applied. *Id. See also Hays v. Pearlman*, 2010 WL 4510956, at *5-7 (D.S.C. 2010).

The Receiver attempts to distinguish *Knauer* on the facts by arguing that Associated "benefited from" the Ponzi scheme. [ECF No. 69 at 11.] But under *Knauer*, a party "benefits from" the fraud, and hence loses the *in pari delicto* defense, only when the party receives a share of the criminal proceeds, something the Receiver does not allege against Associated. In *Knauer*, the defendants were not deemed to have "benefited from" the fraud merely because, as broker-dealers for the Ponzi schemers, they were paid for their services. 348 F.3d at 231-32. Similarly, in *Myatt*, claims against the Bank were dismissed notwithstanding the fees the Bank received—which is exactly what the Receiver alleges here. 635 S.E.2d at 546.

Finally, the Receiver points to *Jones v. Wells Fargo Bank*, 666 F.3d 955 (5th Cir. 2012). But *Jones* turned on the "adverse interest" exception to the *in pari delicto* doctrine, which the Receiver does not argue applies here, and it does not. The adverse interest exception is inapplicable where, as here, fraudsters and the corporation they controlled are one and the same. *Grassmueck v. Am. Shorthorn Ass'n*, 402 F.3d 833, 840 (8th Cir. 2005).

C. It is appropriate to resolve this issue now.

As in *Knauer* and *Hays*, it is appropriate to resolve *in pari delicto* now because it can be resolved as a matter of law based on the allegations in the Complaint. The Receiver does not contest that *in pari delicto* applies so long as the plaintiff is at equal or greater fault than the defendant. (Def.'s Memo. at 9.)

The Receiver's cases deferred resolving the issue only because factual questions remained. In *In re Student Finance Corp.*, 2006 WL 2346373, at *3 (Bankr. D. Del. 2006), the defendant himself was alleged to be a fraudster; not so here. In *In re Phoenix Diversified Inv.*, 439 B.R. 231, 244 (Bankr. S.D. Fla. 2010), it was unclear whether the plaintiff was a wrongdoer at all. Both *Marwil v. Ent & Imler*, 2004 WL 2750255, at *10 (S.D. Ind. 2004), and *Baker O'Neal Holdings v. Ernst & Young LLP*, 2004 WL 771230 (S.D. Ind. 2004), involved allegations that the defendant was potentially more responsible for the wrongful conduct than the plaintiff.

By contrast, in this case, the Complaint demonstrates that the Receivership Entities—who orchestrated and perpetuated the fraud—are principally at fault. It certainly cannot support a claim that Associated's wrongdoing was *greater* than that of the fraudsters.

II. *Res judicata* bars this action.

A party may not sue, lose, and then sue again. And a litigant cannot circumvent this fundamental rule by bringing a second lawsuit through a privy. Yet that is precisely what the Receiver hopes to do.

Associated's argument is neither "illogical[]" [ECF No. 69 at 16] nor a "heads I win, tails you lose" trick (*id.* at 14); it is commonsense and it is the law. To be clear, investors who did not join the Wisconsin suit are not barred by *res judicata*; it is only the *Grad* plaintiffs and their privies who are barred—but that includes the Receiver.

The Receiver makes several implicit concessions: (1) that many investors sued Associated in Wisconsin and lost on the merits (the *Grad* suit); (2) that, if he succeeds in his claims here, those same investors would obtain the very relief they sought in *Grad*; and (3) that, if *res judicata* applies, his entire lawsuit is barred.

The Receiver's two arguments—that he is not in privity with the *Grad* plaintiffs and that he brings different claims—are meritless.

First, *Lamson v. Towle-Jamieson Investment Co.*, 245 N.W. 627, 628 (Minn. 1932), establishes that the Receiver is in privity with the investors as a matter of Minnesota law. There, the Minnesota Supreme Court held that a "creditor of the corporation" is "in privity with the plaintiff receiver, who represented and acted for all the creditors." *Id.* That is *exactly* the situation

here. According to the Receiver, the Receivership Entities owe the investors money (Compl. ¶ 83); the investors are thus creditors of those entities.

The Receiver is correct that, in *Lamson*, the receiver sued first, so *res judicata* barred a subsequent claim by an investor. [ECF No. 69 at 16.] But it makes no difference that the investors sued first here. What matters is the legal conclusion that the parties were in privity. Indeed, *Javitch v. Gottfried*, 2007 WL 81857 (N.D. Ohio 2007), applied *res judicata* to a receiver's action that followed a claim brought first by the investor. The Receiver ignores this authority entirely.

Reil v. Benjamin, 584 N.W.2d 442 (Minn. App. 1998), strongly supports application of *res judicata*. As the Receiver points out, that case holds 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. Because the Wisconsin action was prosecuted by individual investors themselves—the very people the Receiver seeks to benefit—the parties there were *best* positioned to advance these claims.

The Receiver's contention that he "had no control over, no right to be heard in, and no participation in the prior investor lawsuit" is of no consequence. [ECF No. 69 at 15.] What the Receiver ignores is that his appointment—and his prosecution of this suit—is for the benefit of those investors. When, like here, investors have already sued in their own name, there is

nothing left for the Receiver to do. That is why the receiver-creditor relationship is alone sufficient for privity (and *res judicata*) to attach. In *Lamson*, the creditor's claim was barred despite his complete lack of participation in the receiver's earlier action. 245 N.W. 2d at 628.

Commodity Futures Trading Commission v. Chilcott Portfolio Management, 713 F.2d 1477, 1486 (10th Cir. 1983), is inapposite. Privity is a question of state law and *Lamson* is dispositive in Minnesota. Nor does *Chilcott* discuss whether a receiver *is* a privy—but *Lamson*, *Javitch*, and *Britt* do. *Chilcott* is correct that a claim by one investor cannot preclude a claim by another. (*See* Def.'s Memo. at 15.) But a suit by one investor *does* bar the same suit by a *receiver* who acts for his benefit.

The Receiver's second argument is more far-fetched. He asserts that there is no "complete identity of legal theories" because the *Grad* investor's aiding-and-abetting claim was "based on intentional conduct," whereas his claim is supposedly based on "'knowing' conduct." [ECF No. 69 at 15-16.] But *res judicata* attaches "if the same operative nucleus of facts is alleged." *Anderson v. Werner Cont'l*, 363 N.W.2d 332, 335 (Minn. Ct. App. 1985). "For purposes of res judicata a basic factual situation gives rise to one cause of action, no matter how many different theories of relief may apply." *A.B.C.G. Enters. v. First Bank Se.,* 504 N.W.2d 382, 385 (Wis. App. 1993). Whether

Wisconsin law is slightly different than Minnesota has absolutely no bearing on whether the *Grad* plaintiffs already sued on the same facts and lost.[4]

III. The Receiver lacks standing.

The Receiver offers no response to the substance of Associated's standing argument. The Receiver cites cases establishing that he has Article III standing to pursue his claims. [ECF No. 69 at 17-18.] Associated does not disagree. But this has nothing to do with *prudential* standing. And while it is true that Associated does not cite any case dismissing a receiver's third-party tort claims on prudential standing grounds, it is equally true that the Receiver does not cite any case rejecting the argument, nor is Associated aware of any. The fact that our argument is novel does not make it wrong.

The Receiver does not dispute that his action would pose serious constitutional concerns if it bars investors from their own day in court. The presence of an opt-out mechanism has been held a necessary requirement for a class action seeking damages. (Def.'s Memo. at 16-17.) The Receiver's only response is that his action would not have preclusive effect on investors, but that assertion is belied by *Lamson*, 245 N.W. at 628.

These are claims that the investors can—and must—bring. The Receiver lacks standing to do it for them.

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[4] Under the Receiver's theory, the *Grad* investors themselves could, despite having lost once in Wisconsin, sue again in Minnesota on a new legal theory. That is incorrect.

CONCLUSION

The Court should dismiss the Complaint.

Dated: April 14, 2015

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