ORDERED in the Southern District of Florida on September 12, 2013.

Paul G. Hyman, Chief Judge
United States Bankruptcy Court

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
WEST PALM BEACH DIVISION

IN RE:	**CASE NO.: 09-36379-BKC-PGH**
Palm Beach Finance Partners, L.P. and Palm Beach Finance II, L.P., Debtors. /	**CHAPTER 11**
Barry Mukamal, Plaintiff,	**ADV. NO.: 11-02991-BKC-PGH-A**
v.	
Samuel P. Mansour, Defendant. /	

ORDER (I) DENYING DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT AND (II) SETTING PRE-TRIAL CONFERENCE

THIS MATTER came before the Court upon the *Motion for Partial Summary Judgment* (the "Motion for Summary Judgment") (ECF No. 45) filed by Samuel Mansour (the "Defendant"). The Motion for Summary Judgment seeks partial judgment as a matter of law on the *Amended Complaint* (ECF No. 32) filed

by Barry Mukamal (the "Plaintiff") in his capacity as Liquidating Trustee for the Palm Beach Finance Liquidating Trust and the Palm Beach Finance II Liquidating Trust. After considering the parties' submissions and for the reasons discussed below, the Court denies the Defendant's Motion for Summary Judgment as there are material facts in dispute.

BACKGROUND

According to the allegations of the Amended Complaint, Palm Beach Finance Partners, L.P. and Palm Beach Finance II, L.P. (the "Palm Beach Funds") were investors in the purchase financing operation run by Thomas Petters ("Petters") and Petters Company, Inc. ("PCI"). The Plaintiff alleges that Frank Vennes ("Vennes") and his affiliated entity Metro Gem, Inc. ("MGI") made misrepresentations to the principals of the Palm Beach Funds which caused the Palm Beach Funds to invest in Petters' purchase financing operation and ultimately lose money on its investments after Petters' operation was revealed to be a fraud.[1] The Plaintiff further alleges that the Palm Beach Funds became creditors of MGI as a result of these misrepresentations. It is the Palm Beach Funds' alleged status as creditors of MGI that provides the Plaintiff with the requisite standing to pursue the Defendant for the allegedly fraudulent transfers received from MGI.

[1] It was eventually revealed that Petters was not operating a legitimate purchase financing operation, but was instead running a Ponzi scheme. In September 2008, Petters' purchase financing operation was exposed as a Ponzi scheme. In October 2008, Petters was arrested and charged with mail and wire fraud, conspiracy to commit mail and wire fraud, money laundering, and conspiracy to commit money laundering. By April 2010, Petters had been found guilty on all counts and sentenced to 50 years in prison. As a result of this collapse, PCI and other related entities filed voluntary bankruptcy petitions in the United States Bankruptcy Court for the District of Minnesota.

The parties stipulate that MGI was operated as a Ponzi scheme[2] and that the Defendant loaned or invested[3] money with MGI. Specifically, it is undisputed that the Defendant transferred funds to MGI from the period of September 26, 2000, through March 16, 2004, pursuant to promissory notes with MGI (the "Mansour-MGI Promissory Notes"). *See Joint Stipulation of Uncontested Facts* ("Joint Stipulation") (ECF No. 58) at ¶ 2. Despite the fact that the Joint Stipulation recites that they are attached, the Mansour-MGI Promissory Notes are not attached to the Affidavit of Samuel Mansour as Mr. Mansour asserts that he has "practically no records dating back to 2004 and before that relate to [MGI]." Mot. for Summ. J., Ex. 1, at ¶ 5. From January 4, 2002, through May 6, 2004, the Defendant received various transfers MGI. J. Stip. at ¶ 4. The Transfers are summarized in the table attached to the Joint Stipulation as Exhibit 1 and reproduced in part below.

After the collapse of the Petters Ponzi scheme, the Palm Beach Funds filed voluntary chapter 11 bankruptcy petitions on November 29, 2009. *See* 09-36379-BKC-PGH. The Palm Beach Funds filed their *Second Amended Joint Plan of Liquidation* (the "Joint Plan") on September 3, 2010. The Court confirmed the Palm

[2] Although the parties did not include this in their Joint Stipulation, both the Plaintiff and the Defendant, in their respective written submissions, agree that MGI was operated as a Ponzi scheme for the purposes of the Defendant's Motion for Summary Judgment. *See* Mot. for Summ. J. at 4; *Pl.'s Omnibus Resp.* (ECF No. 57) at 2.

[3] The parties characterize the Defendant's relationship with MGI in different ways: the Defendant characterizes the relationship as a "lending" relationship, and the Plaintiff characterizes the relationship as an "investment" relationship. The Court, however, does not assign any particular significance to either term and uses the terms interchangeably.

Beach Funds' Joint Plan by Order dated October 21, 2010.[4] Subsequently, the Plaintiff initiated this adversary proceeding on November 25, 2011, seeking to avoid and recover various transfers pursuant to Minnesota's UFTA and 11 U.S.C. § 541. On July 27, 2012, the Plaintiff filed the Amended Complaint, to which the Defendant filed an *Answer* (ECF No. 37). The Defendant then filed the Motion for Summary Judgment[5] which is now before the Court.

CONCLUSIONS OF LAW

I. Jurisdiction

The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b) and 28 U.S.C. § 157(b).

II. The importance of "reasonably equivalent value"

In Counts I and II, the Plaintiff seeks to avoid and recover as constructively fraudulent transfers made by MGI to the Defendant pursuant to Minnesota Statutes §§ 513.44 and 513.45. Both § 513.44 and § 513.55 provide that in order to recover a transfer on the basis that it was constructively fraudulent when made, the

---

[4] The Joint Plan and the Order Confirming Joint Plan can be found at ECF Nos. 245 and 444, respectively, in Case No. 09-36379-BKC-PGH.

[5] Federal Rule of Civil Procedure 56(a), made applicable to bankruptcy proceedings by Federal Rule of Bankruptcy Procedure 7056, provides that "[t]he courts shall grant summary judgment if the judgment as a matter of law." Fed. R. Civ. P. 56(a). On a motion for summary judgment, the movant bears "the initial burden to demonstrate to the . . . court the basis for its motion . . . and identify those portions of the pleadings, depositions, answers to interrogatories, and admissions which it believes show an absence of any genuine issue of material fact." *Hairston v. Gainesville Sun Pub. Co.*, 9 F.3d 913, 918 (11th Cir. 1993) (citation omitted). In considering a motion for summary judgment, "the court's responsibility is not to resolve disputed issues of fact but to assess whether there are any factual issues to be tried, while resolving ambiguities and drawing reasonable inferences against the moving party." *Knight v. U.S. Fire Ins. Co.*, 804 F.2d 9, 11 (2d Cir. 1986), *cert. denied*, 480 U.S. 932, 107 S.Ct. 1570, 94 L.Ed.2d 762 (1987) (*citing Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 2510, 91 L.Ed.2d. 202 (1986)).

plaintiff must show that the transferor did not receive reasonably equivalent value in exchange for the transfer. The Defendant's Motion for Summary Judgment implicates the meaning of "reasonably equivalent value" in two ways: the Defendant contends that (1) transfers which represent a return of the Defendant's principal investment are not avoidable as they were made in exchange for reasonably equivalent value; and (2) even transfers in excess of the Defendant's principal investment were made in exchange for reasonably equivalent value as they represent interest payments which satisfied an antecedent debt.

As to the first point, the Plaintiff agrees with the Defendant that after conducting a netting analysis, only transfers in excess of the return on the Defendant's principal investment are subject to recovery by the Plaintiff. However, the Plaintiff and the Defendant disagree as to the appropriate method of conducting a netting analysis. As to the second point, the Plaintiff disagrees with the Defendant's contention that the transfers in excess of the Defendant's principal investment were made in exchange for reasonably equivalent value. Instead, the Plaintiff contends that as a matter of law, all transfers in excess of the Defendant's principal investment are avoidable as they constitute "fictitious profits" made in further of an illegal Ponzi scheme.

III. The Plaintiff may not recover transfers which represent a return of the Defendant's principal

A. The netting rule

The general rule in Ponzi scheme cases, subject to the Court's discussion in Section IV, *infra*, regarding contractual interest payments on a debt, is that "a

defrauded investor gives 'value' to the Debtor in exchange for a return of the principal amount of the investment, but not as to any payments in excess of principal." *Perkins v. Haines*, 661 F.3d 623, 627 (11th Cir. 2011); *see also*, *Finn v. Alliance Bank*, Nos. A12–1930, A12–2092, 2013 WL 4711157, at *8 & n.5 (Minn. Ct. App. Sept. 3, 2013) (explaining that many courts adopt the general rule cited above and collecting cases in which courts adopt and apply that rule). In order to apply this general rule, courts generally utilize a "netting analysis" to determine a Ponzi investor's liability under fraudulent transfer law. As explained by the Ninth Circuit Court of Appeals in *Donell v. Kowell*, courts follow a two-step process. "First, to determine whether the investor is liable, courts use the so-called 'netting rule.'" *Donell v. Kowell*, 533 F.3d 762, 771 (9th Cir. 2008), *cert. denied*, 555 U.S. 1047 (2008) (*citing* Mark A. McDermott, *Ponzi Schemes and the Law of Fraudulent and Preferential Transfers*, 72 Am. Bankr. L.J. 157, 168–69 (1998) (surveying federal district court and bankruptcy cases)). Under this first step:

> Amounts transferred by the Ponzi scheme perpetrator to the investor are netted against the initial amounts invested by that individual. If the net is positive, the receiver has established liability, and the court then determines the actual amount of liability, which may or may not be equal to the net gain, depending on factors such as whether transfers were made within the limitations period or whether the investor lacked good faith. If the net is negative, the good faith investor is not liable because payments received in amounts less than the initial investment, being payments against the good faith losing investor's as-yet unsatisfied restitution claim against the Ponzi scheme perpetrator, are not avoidable within the meaning of UFTA.

Donell, 533 F.3d at 771.

"Second, to determine the actual amount of liability, the court permits good faith investors to retain payments up to the amount invested, and requires

disgorgement of only the 'profits' paid to them by the Ponzi scheme." *Id*. at 772 (*citing Fisher v. Sellis (In re Lake States Commodities, Inc.)*, 253 B.R. 866, 872 (Bankr. N.D. Ill. 2000) (collecting cases)). Investors are permitted to retain payments up to the amount invested because:

> [Defrauded investors] have claims for restitution or recision [*sic*] against the debtor that operated the scheme up to the amount of the initial investment. Payments up to the amount of the initial investment are considered to be exchanged for "reasonably equivalent value," and thus not fraudulent, because they proportionally reduce the investors' rights to restitution. If investors receive more than they invested, "[p]ayments in excess of amounts invested are considered fictitious profits because they do not represent a return on legitimate investment activity."

Id. (internal citations omitted) (*quoting In re Lake States Commodities*, 253 B.R. at 872). "Although . . . payments of fictitious profits are avoidable as fraudulent transfers, the appropriate statute of limitations restricts the payments the Ponzi scheme investor may be required to disgorge. Only transfers made within the limitations period are avoidable." *Id*. (citations omitted).

Here, according to the Investment Schedule attached to the Joint Stipulation, the Plaintiff and the Defendant agree that the Defendant made the following investments with MGI:

Date	Amount
09/26/2000	$500,000.00
11/16/2000	$500,000.00
07/03/2001	$600,000.00
11/16/2001	$300,000.00
12/28/2001	$1,000,000.00
01/25/2002	$750,000.00
04/22/2002	$700,000.00
07/25/2003	$300,000.00
09/15/2003	$100,000.00

03/16/2004	$300,000.00
Total investment	**$5,050,000.00**

The Plaintiff and the Defendant also agree, pursuant to the Investment Schedule attached to the Joint Stipulation, that the Defendant received the following transfers from MGI:

Date	Amount
10/26/2000	$12,500.00
11/26/2000	$16,667.00
12/26/2000	$25,000.00
01/26/2001	$25,000.00
02/26/2001	$25,000.00
03/26/2001	$25,000.00
04/26/2001	$25,000.00
06/13/2001	$20,000.00
06/26/2001	$20,000.00
07/26/2001	$20,000.00
08/26/2001	$20,000.00
09/10/2001	$55,200.00
09/10/2001	$600,000.00
10/02/2001	$20,000.00
10/26/2001	$20,000.00
11/26/2001	$22,000.00
12/26/2001	$26,000.00
01/04/2002	$1,000,000.00
01/04/2002	$30,000.00
01/26/2002	$26,000.00
02/26/2002	$26,000.00
03/26/2002	$26,000.00
04/17/2002	$61,500.00
04/26/2002	$27,867.00
05/26/2002	$40,000.00
06/26/2002	$40,000.00
07/26/2002	$34,222.00
08/26/2002	$33,333.00
09/26/2002	$33,333.00
10/26/2002	$33,333.00
11/26/2002	$33,333.00
12/26/2002	$33,333.00
01/26/2003	$33,333.00

02/26/2003	$33,333.00
03/26/2003	$33,333.00
04/26/2003	$33,333.00
05/26/2003	$33,333.00
06/26/2003	$33,333.00
07/26/2003	$33,333.00
08/26/2003	$37,383.00
09/26/2003	$35,606.00
10/26/2003	$36,000.00
11/26/2003	$36,000.00
12/26/2003	$36,000.00
01/26/2004	$36,000.00
01/26/2004	$2,400,000.00
04/16/2004	$3,000.00
05/06/2004	$2,000.00
05/06/2004	$300,000.00
Total transfers	**$6,360,941.00**

Based upon the numbers agreed upon by the Plaintiff and the Defendant and listed in the tables above, the Defendant received $6,360,941.00 in total transfers, but invested only $5,050,000.00. Applying the "netting rule," the Defendant thus received $1,310,941.00 in transfers in excess of the Defendant's principal investment (the "Net Gain"). However, as discussed above, the Defendant's liability may or may not be equal to the Defendant's Net Gain.[6]

Putting aside for the moment the Defendant's argument that even his Net Gain is not subject to recovery by the Plaintiff, the Defendant's prospective liability under Minnesota's Uniform Fraudulent Transfer Act is indeed equal to the Defendant's Net Gain. The Plaintiff and the Defendant agree for the purposes of the

[6] As discussed above, one of the reasons a Ponzi investor's total liability may not be equal to his net gain is if the investor failed to receive the transfers in good faith. In such a case, the plaintiff could seek to avoid amounts which represent a return on the investor's principal as well as amounts representing the investor's net gain. Here, however, the Plaintiff is not contending that the Defendant failed to receive the transfers in good faith and is therefore not seeking to avoid and recover transfers representing a return on the Defendant's principal investment. *See Pl.'s Omnibus Resp.* (ECF No. 62), at 2 n.1.

Defendant's Motion for Summary Judgment that Minnesota's six-year statute of limitations applies. Accordingly, in order for a transfer to be recoverable under Minnesota's UFTA, the transfer must have occurred on or after November 31, 2003—six years prior to the Palm Beach Funds' bankruptcy filing. As evidenced by the Investment Schedule attached to the parties' Joint Stipulation and discussed above, the Defendant received six transfers from MGI totaling $2,777,000.00 within the statute of limitations period:

Date	Amount
12/26/2003	$36,000.00
01/26/2004	$36,000.00
01/26/2004	$2,400,000.00
04/16/2004	$3,000.00
05/06/2004	$2,000.00
05/06/2004	$300,000.00
Total transfers	**$2,777,000.00**

Therefore, because the Defendant received more than $1,310,941.00 within the statute of limitations period, the Defendant's total potential liability for transfers received within the statute of limitations period is $1,310,941.00, which is equal to the Defendant's Net Gain over the life of the Defendant's relationship with MGI. The remaining $1,466,059.00 received by the Defendant from MGI within the statute of limitations period is a return on principal and is thus not recoverable by the Plaintiff as it was made in exchange for reasonably equivalent value.[7]

[7] As discussed below, transfers representing a return on an investor's principal are considered to have been made in exchange for reasonably equivalent value based on the following theory: A defrauded investor gives "value" to the Ponzi scheme perpetrator in exchange for a return of the principal amount of investment because defrauded investors have a claim for fraud against the Ponzi scheme perpetrator arising as of the time of the initial investment. Thus, any transfer up to the amount of the principal investment satisfies the investors' fraud claim (an antecedent debt) and is made for "value" in the form of the investor's surrender of his or her tort claim. *Perkins*, 661 F.3d at 627

B. The netting rule is not applied on a loan-by-loan basis

The Defendant disagrees with the netting method applied by the Court in the preceding section and instead, contends that the "netting rule" must be applied on a loan-by-loan basis. The Defendant asserts that all but two loans were repaid outside of the statute of limitations period, and that as a result, these loans paid outside of the statute of limitations period, and their corresponding repayments must not be included in the Court's netting analysis. According to the Defendant, the only loans from the Defendant to MGI which can be included in the netting analysis are the $300,000.00 March 16, 2004 loan and the $2,400,00.00 loan which was made pursuant to an unspecified "prior promissory note." Mot. for Summ. J. at 3, 6. Likewise, the Defendant asserts that only five transfers from MGI to the Defendant may be included in the Court's netting analysis: (1) $36,000.00 on December 8, 2003; (2) $36,000.00 on December 20, 2003; (3) $2,400,000.00 on January 26, 2004; (4) $3,000.00 on April 26, 2004; and (5) $302,000.00 on May 6, 2004. Based upon the Defendant's position, the net amount received by the Defendant which may represent fictitious profits is $77,000.00. This analysis is problematic for several reasons.

To begin with, the Defendant's numbers and dates do not match with what is reflected in Schedule 1 attached to the Amended Complaint or, more importantly, the Investment Schedule attached to the Joint Stipulation. First, the Defendant refers to a $2,400,000.00 promissory note, but does not specify the date that the promissory note was made or when the money was loaned. Instead, the Defendant,

in his affidavit attached to the Motion for Summary Judgment, states: "As of November 30, 2003, I recall that all of my loans with [MGI] had been paid off and satisfied except for an outstanding loan in the principal sum of $2,400,000.00 which called for monthly interest payments of $36,000.00 (or 1.5% per month). . . . On January 26, 2004, [MGI] satisfied this $2,400,000.00 loan by paying me this sum." Mot. for Summ. J., Ex. 1 at ¶¶ 6-7. The Investment Schedule attached to the Joint Stipulation does not, however, reflect any transfer from the Defendant to MGI in the amount of $2,400,000.00. Notwithstanding the Defendant's assertions to the contrary, the loans and transfers listed in the Investment Schedule attached to the Joint Stipulation were stipulated to by both the Plaintiff *and* the Defendant. Therefore, the Court considers the numbers and listed in the Investment Schedule to be undisputed and conclusive.

Furthermore, the Defendant's netting method ignores all the transfers which took place outside of the statute of limitations and the fact that the supposed $2,400,000.00 loan almost certainly occurred outside of the statute of limitations period. The Defendant refers to the $2,400,000.00 loan, and the March 16, 2004, loan in a vacuum. The Defendant does not acknowledge or attempt to explain the nine other loans reflected in the Investment Schedule. The Defendant also fails to explain the monthly transfers which must have been attributable at least in part to the $2,400,000.00 loan. Accordingly, although the Defendant wishes to include the principal amount of the $2,400,000.00 loan, made pursuant to an unspecified promissory note, in his netting analysis, he wishes to ignore the undeniable fact

that some of the transfers from MGI to the Defendant which occurred outside of the statute of limitations period must have been made pursuant to this $2,400,000.00 loan.[8] This is how the Defendant arrives at a netting analysis which nets loans originating both inside and outside the statute of limitations period against only the transfers from MGI to the Defendant which occurred within the statute of limitations period. This analysis is illogical and finds no support in case law.

More importantly, two general rules negate the applicability of the Defendant's suggested netting method: (1) the very nature of the two-step analysis articulated by the *Donell* court contradicts the notion that the netting analysis must be limited to transfers which occurred within the applicable statute of limitations period, and (2) tracing transfers to specific investments is unnecessary and unworkable when analyzing fraudulent transfers in the context of a Ponzi scheme.

In *Donell*, the court noted that after netting amounts transferred to the investor against the principal amounts invested by that individual, "[i]f the net is positive, the receiver has established liability, and the court then determines the actual amount of liability, which may or may not be equal to the net gain, *depending on factors such as whether transfers were made within the limitations period*." 533 F.3d at 771 (emphasis added). If the court were only netting amounts transferred within the statute of limitations period, this added step would be unnecessary, as the liability would always be equal to the net gain. Other courts

[8] This is because the first $2,350,000.00 in loans from the Defendant to MGI necessarily would have been repaid first on a "first in, first out" basis and would have been repaid in full prior to many of the transfers made by MGI to the Defendant.

have similarly held that "[a]lthough a court may not require a defendant/transferee to disgorge profits received outside the applicable statute of limitations, the court must nevertheless net the total amount transferred by the debtor to the defendant/transferee against the amounts invested by the defendant/transferee in order to assess the defendant's liability." *Ivey v. Connolly (In re Whitley)*, Adv. No. 11-2025, 2013 WL 1910386, at *8 (Bankr. M.D. N.C. May 1, 2013). Accordingly, the Court finds that there is no merit to the Defendant's contention that only transfers which occurred within the statute of limitations period are subject to the netting analysis.

The *Donell* Court also considered whether the Court must conduct a tracing analysis, so as to connect transfers with particular investments:

> [The defendant] argues that the district court should have required the Receiver to trace the transfers and demonstrate whether the three payments within the statutory period were return of principal or profit. He argues that if some of the transfers from within the statutory period were returns of the principal which [the defendant] invested before the statutory period, these transfers would also fall outside of the statute of limitations. [The defendant's] proposed tracing requirement is unsupported by law and would be unmanageable in practice.

533 F.3d at 773-74. In other words, "the trustee need not match up each investment with each payment made by the debtor and follow the parties' characterizations of the transfers." *In re Lake States Commodities*, 253 B.R. at 872.

Accordingly, the appropriate way to conduct a netting analysis is to aggregate all amounts invested by the Defendant with MGI and all amounts received by the Defendant from MGI. After aggregating these amounts, the Court compares the

total amount invested with the total amount received. If the net is positive, meaning the Defendant received more than he invested, the Plaintiff has established liability. The Court may then determine the actual amount of liability, which may or may not be equal to the net gain, depending on factors such as whether transfers were made within the limitations period or whether the investor lacked good faith.

Therefore, as discussed in the proceeding subsection, the Defendant's total Net Gain over the life of the Defendant's relationship with MGI is $1,310,941.00, the total amount of which may be satisfied by transfers which occurred within the statute of limitations period. Accordingly, subject to the Court's discussion in Section IV below, the Defendant's total potential liability is $1,310,941.00.

IV. Whether interest payments can ever constitute "reasonably equivalent value"?

Notwithstanding the arguments and analysis discussed above, the Defendant contends that the Plaintiff may not avoid and recover even the Defendant's Net Gain because the Defendant was not an "investor" in MGI. Rather, the Defendant asserts that he was an ordinary creditor of MGI who loaned money to MGI pursuant to a series of promissory notes which provided for the payment of commercially reasonable, fixed rates of interest. Thus, according to the Defendant, his Net Gain amounts to nothing more than payments of commercially reasonable interest which were made by MGI in exchange for reasonably equivalent value—the satisfaction of MGI's contractual debt to the Defendant.

"There is a sharp split of authority on the issue of whether the payment of interest by a Ponzi scheme operator can ever constitute reasonably equivalent value." *Daly v. Deptula (In re Carrozzella & Richardson),* 286 B.R. 480, 487 (D. Conn. 2002); *see also, Rieser v. Hayslip (In re Canyon Sys. Corp.)*, 343 B.R. 615, 639 (Bankr. S.D. Ohio 2006). While "[c]ourts almost universally hold that the transfer of 'false profits' from a Ponzi scheme is not made in exchange for value[,] . . . courts are decidedly less uniform where an investor enters into a contract with the Ponzi scheme for interest payments." *Janvey v. Alguire*, No. 3:09-CV-0724-N, 2013 WL 2451738, at *9 (N.D. Tex. Jan. 22, 2013). There are two separate lines of authority—the Discrete Transaction Approach and the Scheme-Based Approach—which find support within case law.

A. The Discrete Transaction Approach

The first line of authority holds that in appropriate circumstances, the payment of interest to innocent investors pursuant to a contractual obligation may constitute the satisfaction of an antecedent debt and therefore in those circumstances, is made in exchange for reasonably equivalent value (the "Discrete Transaction Approach"). *See, e.g.*, *In re Carrozzella & Richardson,* 286 B.R. 480; *Lustig v. Weisz & Assocs., Inc. (In re Unified Commercial Capital) (In re Unified Commercial Capital II)*, 2002 WL 32500567 (W.D.N.Y. June 21, 2002).[9]

[9] Other decisions which follow the Discrete Transaction Approach include: *Kipperma v. Anthony & Morgan Sur. And Ins. Servs., Inc. (In re Commercial Money Ctr.)*, Adv. No. 04–90235–H7, 2008 WL 7889835, at *7 (Bankr. S.D. Cal. Jan. 3, 2008); *Orlick v. Kozyak (In re Financial Federated Title & Trust, Inc.)*, 309 F.3d 1325 (11th Cir. 2002) (concluding that a determination of value given "should focus on the value of the goods and services provided rather than on the impact that the goods and services had on the bankrupt enterprise"); *Carroll v. Stettler,* No. 10–2262, 2013 WL 1702636, at *7 (E.D. Pa. Apr. 18, 2013) (noting that "[t]he statute's iteration of the affirmative defense, as well as its

The proposition underlying the Discrete Transaction Approach is that in the context of determining reasonably equivalent value, the appropriate focus is the specific relationship between the defendant and the transferor and "the discrete transaction between the [transferor] and the defendant, without regard to the nature of the [transferor's] overall enterprise." *In re Carrozzella & Richardson,* 286 B.R. at 487-88 (*citing Solow v. Reinhardt (In re First Commercial Mgmt. Grp., Inc.*), 279 B.R. 230, 236 (Bankr. N.D. Ill. 2002)). Citing the narrow and clear language of the Uniform Fraudulent Transfer Act, courts following the Discrete Transaction Approach measure "what was given against what was received *in that transaction*." *Id*. at 488 (citations omitted) (emphasis in original). In doing so, these courts do not emphasize the existence and nature of the transferor's Ponzi scheme. As one court explained:

> [T]he statutes and case law do not call for the court to assess the impact of an alleged fraudulent transfer in a debtor's overall business. The statutes require an evaluation of the specific consideration exchanged by the debtor and the transferee in the specific transaction which the trustee seeks to avoid, and if the transfer is equivalent in value, it is not subject to avoidance under the law

Id. at 488-89 (*quoting Balaber-Strauss v. Sixty-Five Brokers (In re Churchill Mortg. Inv. Corp.)*, 256 B.R. 664, 680 (Bankr. S.D.N.Y. 2000), *aff'd*, *Balaber–Strauss v. Lawrence*, 264 B.R. 303 (S.D.N.Y. 2001)). In other words, "[s]imply because a debtor conducts its business fraudulently does not make every single payment by the

---

definition of a 'reasonably equivalent value,' makes no mention of a scheme-based analysis of the transaction; rather, in stating that a transfer is not fraudulent 'against a person who took in good faith and for a reasonably equivalent value," the focus is placed on the specific transferee and the specific transfer'"); *Goldberg v. Chong*, No. 07–20931–CIV, 2007 WL 2028792, at *5 (S.D. Fla. July 11, 2007).

debtor subject to avoidance." *Id.* at 489 (*quoting Cuthill v. Greenmark, LLC (In re World Vision Entm't, Inc.)*, 275 B.R. 641, 658 (Bankr. M.D. Fla. 2002)).

Courts embracing the Discrete Transaction Approach further emphasize that a transferor's "use of the investor's funds for a period of time supported the payment of reasonable contractual interest" and that if the drafters of the Uniform Fraudulent Transfer Act did not intend such a result when the transferor was involved in a Ponzi scheme, they should have so specified rather than leaving it to the courts to ignore what is clearly value and fair consideration under the fraudulent conveyance statutes. *Id.* at 489 (*citing Lustig v. Weisz & Assocs., Inc. (In re Unified Commercial Capital) (In re Unified Commercial Capital I)*, 260 B.R. 343, 350 (Bankr. W.D.N.Y. 2001), *aff'd* 2002 WL 32500567 (W.D.N.Y. June 21, 2002)). The Courts in *In re Carrozzella & Richardson* and *In re Unified Commercial Capital I* noted that "[b]y forcing the square peg facts of a 'Ponzi' scheme into the round holes of the fraudulent conveyance statutes in order to accomplish a further reallocation and redistribution to implement a policy of equality of distribution in the name of equity, . . . many courts have done a substantial injustice to those statutes and have made policy decisions that should be made by Congress." *In re Carrozzella & Richardson*, 286 B.R. at 489 (*quoting In re Unified Commercial Capital I*, 260 B.R. at 350)).

Finally, according to those courts which follow the Discrete Transaction Approach, followers of the Scheme-Based Approach simply "ignore the 'universally accepted fundamental commercial principal that, when you loan an entity money

for a period of time in good faith, you have given value and you are entitled to a reasonable return.'" *Id.* (*quoting In re Unified Commercial Capital I,* 260 B.R. at 350). These courts question "why innocent investors should be treated any differently than a Ponzi-scheme operator's trade creditors, such as utility companies and landlords, since the payment of contractual debts owing to these trade creditors diminishes the debtor's estate in the same manner that payment of reasonable contractual interest to innocent investors diminishes the estate." *Id.* at 490 (*citing In re Unified Commercial Capital I,* 260 B.R. at 352; *In re World Vision Entm't, Inc.*, 275 B.R. at 658).

B. The Scheme-Based Approach

On the other hand, there is ample case law supporting the position that any transfer by a Ponzi scheme perpetrator to a transferee over and above the total amount invested by the transferee is not, as a matter of law, supported by reasonably equivalent value (the "Scheme-Based Approach"). *See Janvey*, 2013 WL 2451738, at *9 (citing cases which following the Scheme-Based Approach); *In re Canyon Sys. Corp.*, 343 B.R. at 639-40 (same). The Scheme-Based Approach starts, of course, with the general principle of Ponzi scheme jurisprudence that "when facing fraudulent conveyance actions, investors may keep the principal amount of their investments, but they may not keep any profits from the scheme." *In re Carrozzella & Richardson,* 286 B.R. at 487-88 (*quoting In re First Commercial Mgmt. Grp., Inc.*, 279 B.R. at 236); *see also, Perkins*, 661 F.3d at 627 (Eleventh Circuit case recognizing the general principle that any transfers over and above the

amount of the principal are not made for "value" because they exceed the scope of the investors' fraud claim); *Donell*, 533 F.3d at 770 (Ninth Circuit recognizing the same principle). However, the Scheme-Based Approach, as its name suggests, does not separately examine each discrete investment and each individual defendant. Instead, courts following the Scheme-Based Approach ignore the characteristics of the particular defendant and investment at issue and make no distinction between an ordinary lender of money, who expects a commercially reasonable interest rate, and a typical Ponzi investor, who expects a Ponzi-like rate of return.

More specifically, courts which follow the Scheme-Based Approach accept the premise that contracts with Ponzi schemes are *per se* void and unenforceable. *Janvey*, 2013 WL 2451738, at *10. As the argument goes, any contract entered into with a company that turns out to be a Ponzi scheme is void because the value, which serves only to perpetuate an illegal fraud, is illegal. [10] *Carroll v. Stettler,* No. 10–2262, 2013 WL 1702636, at *7 (E.D. Pa. Apr. 18, 2013). From this premise, "the general rule that investors may keep principal payments but must return interest

---

[10] Courts which follow the Scheme-Based Approach emphasize the nature of the "value" given to the Ponzi scheme by an investor:

> "[V]alue" must be viewed from an objective standpoint and . . . if use of the investors' money was of "value" to the debtor, the only "value" was to perpetuate the Ponzi scheme. Therefore, the "value" of that money, if anything, was "negative value." Further, by helping the debtor perpetuate his illegal scheme, the transfers between the debtor and investors only exacerbated the harm to the debtor's creditors by increasing the amount of claims, while diminishing the debtor's estate.

In re Carrozzella & Richardson, 286 B.R. at 487 (*citing In re Taubman*, 160 B.R. 964, 986 (Bankr. S.D. Ohio 1993); *Martino v. Edison Worldwide Capital (In re Randy)*, 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995)); *see also*, *Janvey*, 2013 WL 2451738, at *9; *Donell*, 533 F.3d at 777; *Scholes v. Lehman*, 56 F.3d 750, 757 (7th Cir. 1995) (noting that the "paying out of profits to [defendant] not offset by further investments by him conferred no benefit on the corporations but merely depleted their resources faster").

payments necessarily follows." *Janvey*, 2013 WL 2451738, at *10. The investor has a claim for fraud or restitution for the principal he or she was fraudulently induced to lend. However, investors do not have a claim, absent the contractual one which is void and unenforceable, for their interest payments. *Id.* (*citing Bayou Superfund, LLC v. WAM Long/Short Fund II, LP (In re Bayou Group, LLC)*, 362 B.R. 624, 635 (Bankr. S.D.N.Y. 2007); 47 C.J.S. *Interest & Usury* § 136 ("[W]here interest is recoverable other than under a contract, and payment of the principal as such is made and accepted, no interest can be recovered, the payment of the debt extinguishing the right to recover interest thereon. Interest, in such a case, is merely incidental to the debt or principal and cannot exist without it. Thus interest cannot be recovered in a separate action.")). It follows that "[b]ecause the investors have a claim for their principal, those payments paid down an antecedent debt and, as such, were given for value." *Janvey*, 2013 WL 2451738, at *10. However, because the investors had no claim for interest, such payments were not given in exchange for value. *Id.*

Furthermore, at its most basic level, the theory behind the Scheme-Based Approach "is that to allow the investors in these fraudulent schemes to keep payments in excess of their actual investments would . . . allow them to profit at the expense of those investors who entered the scheme later and received nothing." *In re Carrozzella & Richardson,* 286 B.R. at 487 (*citing In re First Commercial Mgmt. Grp., Inc.*, 279 B.R. at 236). Courts universally recognize that forcing net winners to pay back interest payments will cause some hardship and pain. *See Janvey*, 2013

WL 2451738, at *10. However, "for victims of a Ponzi scheme, everyone is a loser." *Id*. Courts applying the Scheme-Based Approach reason that permitting net winners "to keep their fraudulent above-market returns in addition to their principal would simply further victimize the true [Ponzi] victims, whose money paid the fraudulent interest." *Id*. After all, even net winners who are required to repay interest payments will be in far better shape than most Ponzi victims, having recovered at least their principal investment. *Id*. These considerations lead many courts to conclude that the Scheme-Based Approach is the best approach, finding that "avoiding the interest payments is the most equitable and just solution to a difficult problem." *Id*. (*citing Donell*, 533 F.3d at 780).

C. The Court will follow the Discrete Transaction Approach

Underlying the Court's determination as to whether it should follow the Discrete Transaction Approach or the Scheme-Based Approach is the interpretation of Minnesota's Uniform Fraudulent Transfer Act. As discussed above, the Plaintiff seeks to avoid and recover as constructively fraudulent transfers made by MGI to the Defendant pursuant to Minnesota Statutes §§ 513.44 and 513.45. Both §513.44 and § 513.55 provide that in order to recover a transfer on the basis that it was constructively fraudulent when made, the Plaintiff must show that MGI made the transfer to the Defendant without receiving reasonably equivalent value.

In construing questions of state law, federal courts must apply state law in accordance with the controlling decisions of the highest court of the state whose law is at issue. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188

(1938); *Risley v. Nissan Motor Corp. USA*, 254 F.3d 1296, 1299 (11th Cir. 2001); *Caban v. J.P. Morgan Chase & Co.*, 606 F.Supp.2d 1361, 1367 (S.D. Fla. 2009). "Where the highest court in a state is silent on a particular issue, a federal court may look to other courts in the state for guidance." *Caban*, 606 F.Supp.2d at 1367. Indeed, "[a] federal court applying state law is bound to adhere to decisions of the state's intermediate appellate courts absent some persuasive indication that the state's highest court would decide the issue otherwise." *Silverberg v. Paine, Webber, Jackson & Curtis, Inc.*, 710 F.2d 678, 690 (11th Cir. 1983); *see also, Fidelity Union Trust Co. v. Field*, 311 U.S. 169, 177-78, 61 S.Ct. 176, 85 L.Ed. 109 (1940); *Ross v. Jefferson Cnty. Dept. of Health*, 701 F.3d 655, 659 (11th Cir. 2012).

A recent opinion issued by the Minnesota Court of Appeals construes the meaning of "reasonably equivalent value" under Minnesota's UFTA and thus guides the Court's analysis. In *Finn v. Alliance Bank*, First United Funding LLC and Corey Johnston sold loan participations to various banks and other financial institutions from 2002 through 2009. Nos. A12–1930, A12–2092, 2013 WL 4711157, at *1 (Minn. Ct. App. Sept. 3, 2013).[11] During this time, First United and Johnston were engaged in a fraudulent enterprise, in which they oversold participations and sold participations in fictional loans. Because First United was insolvent, in order to pay interest and profits to its investors, First United and Johnston used funds obtained from later investors, which were commingled in First United's bank accounts. *Id.* Among the loan participations that First United sold were those to the

[11] *Finn v. Alliance Bank* was selected for publication and will eventually be included in the North Western Reporter (N.W.2d). However, because the decision was issued less than two weeks prior to the entry of this Order, only the Westlaw citation is available.

defendant. The defendant purchased a 100% participation interest in a $3,180,000.00 loan made to a borrower in 2002. The borrower made payments on the loan to First United through 2007, and First United made payments to the defendant. The borrower paid off the loan in 2007, including $1,332,058.00 in interest and fees. First United, in turn, paid off the defendant's participation interest in 2008, including the principal and $1,235,388.00 in interest and fees. *Id.* at *2.

Johnston was later charged with bank and tax fraud relating to the operation of a Ponzi scheme. *Id.* After First United was placed into receivership, the receiver commenced the original action against the defendant, seeking to avoid and recover profits received by the defendant pursuant to Minnesota's UFTA. *Id.* Subsequently, the district court granted the receiver's motion for summary judgment and directed entry of judgment against the defendant in the amount of $1,235,388.00. *Id.* at *3.

On appeal, the *Finn* court considered whether the lower court properly applied the Ponzi-scheme presumption that "to the extent innocent investors have received payments in excess of the amounts of the principal that they originally invested, those payments are avoidable as fraudulent transfers." *Id.* at *8 (*quoting Donell*, 533 F.3d at 770). The *Finn* court noted that application of the Ponzi-scheme presumption to the claims at bar would have three effects: (1) to establish actual intent to defraud based upon the mere existence of a Ponzi scheme; (2) to establish that the Ponzi scheme perpetrator was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were

unreasonably small or that the perpetrator intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due; (3) and most importantly, to establish that all profits received by an investor in a Ponzi scheme, even if taken in good faith, were not received in exchange for reasonably equivalent value. *Id*. at *9 (*citing Donell*, 533 F.3d at 770-72, 777-78).

After considering the justifications given by other courts for applying the third Ponzi-scheme presumption, the *Finn* court held that the lower court erred in presuming that all profits were not received for reasonably equivalent value. *Id*. at *12 (stating that the justifications given by other courts do not apply to the receiver's claims against the defendant). The court reasoned that:

> Value is given if the transfer satisfies an antecedent debt. Minn. Stat. § 513.43(a). Here, the record establishes that [the defendant] purchased a participation interest in a loan made by First United to a legitimate borrower and that the borrower repaid First United the loan principal, plus required interest and fees. Moreover, the receiver did not allege in the district court, nor does it argue on appeal, that First United's payments to [the defendant] depleted First United's assets as envisioned by the court in *Donell* or the drafters of the UFTA, or that the underlying loan that [the defendant] participated in was in any way oversold or nonexistent. Further, the receiver does not assert that [the defendant] lacked good faith when it entered into the loan-participation agreement with First United.

Id. (internal citations omitted). The *Finn* court further reasoned that "[a]pplying the presumption that profits were not received for reasonably equivalent value to the claims against [the defendant] would create an exception to the MUFTA's . . . reasonably-equivalent-value element of constructive fraud" and that "[i]f an exception to the MUFTA is to be adopted in Minnesota in Ponzi-scheme cases, it

must be done by the supreme court or the legislature, not this court." *Id.* Accordingly, the *Finn* court held that it would not adopt a presumption that as a matter of law, profits received from a Ponzi scheme perpetrator are not received for reasonably equivalent value. *Id.* The *Finn* court's recognition that there is no binding authority adopting such a presumption under Minnesota state law and refusal to adopt such a presumption are binding on this Court.

As discussed above, the Plaintiff's fraudulent transfer claims were brought pursuant to Minnesota's Uniform Fraudulent Transfer Act. Accordingly, the Court must apply Minnesota law in accordance with the controlling decisions of the Minnesota Supreme Court. The Minnesota Supreme Court has not ruled on the issue of whether it can be presumed as a matter of law that profits received from a Ponzi scheme perpetrator are not received for reasonably equivalent value. Accordingly, the Court will follow the decision of the Minnesota Court of Appeals in the absence of any persuasive indication that the state's highest court would decide the issue otherwise. The Minnesota Court of Appeals in *Finn* rejected the presumption that profits received from a Ponzi scheme perpetrator can never be deemed to have been received in exchange for reasonably equivalent value. Further, in issuing its decision, the *Finn* court considered the particulars of the discrete investment transaction which took place between the defendant and First United. The Court is not aware of any persuasive indication that the Minnesota Supreme Court would rule differently when faced with this issue. Accordingly, the *Finn* decision requires that the Court focus on the particular defendant and investment

transaction at issue—on the value of the goods and services provided rather than on the impact the goods and services had on the overall Ponzi scheme—when analyzing whether reasonably equivalent value was given in exchange for a transfer in the context of a claim under Minnesota's UFTA.

For the reasons discussed above, the Court will follow the Discrete Transaction Approach and will not presume that MGI failed to receive reasonably equivalent value for the profits paid to the Defendant. Instead, the Court will consider the circumstances surrounding the relationship between the Defendant and MGI and the particular terms of the transactions between the Defendant and MGI. However, the determination of whether a transfer was received in exchange for reasonably equivalent value is a question of fact, and factual disputes remain as to whether the terms of the transactions were commercially reasonable and whether the transfers in excess of the Defendant's principal investment were made in exchange for reasonably equivalent value. Therefore, the Court will deny the Defendant's Motion for Summary Judgment.

V. Conclusion

As discussed above, over the life of his investment relationship with MGI, the Defendant received $1,310,941.00 in transfers from MGI in excess of his principal investment. Taking into consideration Minnesota's six-year statute of limitations, the entire $1,310,941.00 would be recoverable by the Plaintiff should the Plaintiff establish by a preponderance of the evidence all of the statutory requirements of Minnesota's Uniform Fraudulent Transfer Act.

One of these requirements is that the transfers to the Defendant must have been made without MGI receiving reasonably equivalent value in exchange for the transfers. As the Court concluded in the preceding section, there is no legal presumption under Minnesota law that all transfers exceeding a investor's principal investment were made without receiving reasonably equivalent value in the context of a Ponzi scheme. Accordingly, the Court will consider the circumstances surrounding the relationship between the Defendant and MGI and the particular terms of the transactions between the Defendant and MGI in order to determine whether MGI received reasonably equivalent value in exchange for the transfers to the Defendant which exceeded the Defendant's principal investment. However, because issues of material fact remain which prevent the Court from determining whether MGI received reasonably equivalent value in exchange for the $1,310,941.00, the Court will deny the Defendant's request for summary judgment.

ORDER

Being fully advised in the premises and for the reasons discussed above, the Court hereby **ORDERS AND ADJUDGES** that:

1. The Defendant's Motion for Summary Judgment (ECF No. 45) is **DENIED**.
2. A pre-trial conference shall be held before the Honorable Paul G. Hyman on **November 13, 2013 at 11:00 a.m.** at the United States Bankruptcy Court, Flagler Waterview Building, 1515 N Flagler Dr., Room 801, 8th floor, Courtroom A, West Palm Beach, FL 33401.

###

Copies furnished to:

Michael S Budwick, Esq.

G Steven Fender, Esq.