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

	Chapter 11
PALM BEACH FINANCE PARTNERS, L.P.,	CASE NO. 09-36379-EPK
PALM BEACH FINANCE II, L.P.,	CASE NO. 09-36396-EPK
	(Jointly Administered)
Debtors.	

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MOTION OF MELAND BUDWICK, P.A. FOR ADDITIONAL FEE PURSUANT TO COURT APPROVED 2010 FEE AGREEMENT

Meland Budwick, P.A. ("***MB***"), counsel to Barry E. Mukamal ("***Trustee***") as Liquidating Trustee for the Palm Beach Finance Liquidating Trust ("***PBF I Trust***") and the Palm Beach Finance II Liquidating Trust ("***PBF II Trust***," and together with the PBF I Trust, the "***Trusts***"),[1] respectfully requests ("***Motion***") an award of an additional fee ("***Additional Fee***") as contractually provided in the fee agreement this Court approved in 2010.[2] The Trustee supports the requested relief. In support, MB states as follows.[3]

I. Introduction

MB is privileged to have worked with the Trustee to benefit victims of the Petters Ponzi Scheme,[4] the third-largest Ponzi scheme in American history.[5] MB appreciates the substantial time

[1] The Trusts are the successors to Palm Beach Finance, L.P. ("***PBF I***") and Palm Beach Finance II, L.P. ("***PBF II***," and together with PBF I, the "***Debtors***").
[2] Each of MB's post-confirmation fee applications since 2010 refers to the right to seek an additional fee at an appropriate time. *See e.g.* ECF Nos. 3645, 3673 and 3694, each at page 14. *See also e.g.* Order Granting MB's 23rd Post-Confirmation Fee Application ECF No. 3541, ¶6.
[3] Neither MB or the Trustee intends to nor waives any privileges or confidentiality.
[4] "***Petters Ponzi Scheme***" shall mean the *Ponzi* scheme perpetrated by Thomas J Petters through which he and his co-conspirators stole approximately $1.9 billion (cash-on-cash) from lenders, from approximately 1995 – 2008.
[5] The two Ponzi schemes in American history that resulted in losses greater than the Petters Ponzi Scheme were the ones perpetrated by Bernie Madoff and Allen Stanford.

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and resources devoted to these cases by this Court including the Honorable Paul G. Hyman (retired) for eleven years.

When the Trustee retained MB in February 2010, the estates had no cash or resources to pay professionals or costs and faced many challenges. After negotiations among MB, the Trustee, Geoffrey Varga (a Cayman-Court appointed fiduciary for the Debtors' largest creditor), and Mr. Varga's counsel, and notice to all parties, this Court approved a comprehensive alternative fee arrangement. MB would be paid: (1) hourly rates for certain matters; (2) reduced hourly rates coupled with a contingency fee for certain matters; and (3):

> Depending on the outcome and results achieved in connection with the Debtors' cases, including the results of and amounts of distributions from the Petters Bankruptcy Cases, [MB] shall be entitled to seek additional fees based on the results achieved.[6]

In 2011, a fourth category was added: MB would pursue two matters on a pure contingency fee basis.[7]

While administration of the PBF Cases[8] has not concluded, they are approaching completion, thus enabling the Court to assess the "results achieved." By separate motion, the Trustee seeks approval of a fourth interim distribution to stakeholders. Instead of reserving a meaningful amount, MB requests the Court now to consider the Additional Fee.

The goal of the 2010 alternative-fee arrangement was to shift financial risk onto MB, as the Trustee's lead counsel at a time when the Debtors lacked resources to pay professionals. Even the reduced hourly component of MB's fees was at risk. MB accepted this risk and never wavered. In contrast, by September 2013, Mr. Varga – the Court-appointed Trust Monitor and junior estate

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[6] ECF Nos. 193 ¶20 & 223 ¶4.
[7] ECF Nos. 802 & 815.
[8] "***PBF Cases***" means the above-captioned, jointly-administered bankruptcy cases.

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fiduciary – considered the financial risk to his firm to be "*untenable*." Mr. Varga held two claims totaling over $718 million against PBF II, roughly (i) 95% of all claims in PBF II[9] and (ii) 80% of all claims in PBF I and PBF II combined. From 2010 through 2013, Mr. Varga and his team of financial and legal professionals were paid over $6.3 million in the PBF Cases.[10] They had access to the Trustee's confidential investigatory work product. Well-positioned to assess potential recoveries, Mr. Varga concluded that the prospects for recovery on his two claims were dim. To protect his firm, Mr. Varga sold a 100% beneficial interest in his claims to a New York-based hedge fund for $16 million.

After years of litigation, the Trustee has recovered $229,855,252, including $200 million since October 1, 2013, *after* Mr. Varga sold his claim. MB has been instrumental to the Trustee's remarkable accomplishments. After the upcoming fourth distribution, the Trustee will have distributed over $111 million to the hedge fund that bought Mr. Varga's position,[11] over $95 million more than the price it paid to Mr. Varga.

Based on all the circumstances and the results achieved, MB respectfully requests this Court to award MB an Additional Fee in the amount of $5 million. Below, MB summarizes the achievements by the Trustee and MB since February 2010.[12]

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[9] This effective percentage is based on application of § 510(b). *See e.g.* ECF No. 3660 at page 7 of 30 which provides for Mr. Varga's claims to receive 96.3% of the third interim distribution from the PBF II Trust.

[10] Fees were paid to Kinetic Partners (Cayman) Ltd., Reed Smith, Tew Cardenas, Levine Kellogg and Campbells Law Firm in the Cayman Islands.

[11] Stonehill (defined below) has received $93,168,000 in three interim distributions from January 2018 through November 2019. The Trustee's impending fourth interim distribution to Stonehill of $18,682,200 will increase the total to roughly $111,850,200.

[12] MB is mindful that "[a] request for attorney's fees should not result in a second major litigation." *Taylor Newman Cab., Inc. v. Classic Soft Trim, Inc.*, 436 F. App'x 888, 895 (11th Cir. 2011) (citations omitted).

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II. The Trustee

This Motion describes a joint effort with the Trustee who led and was intimately involved in all facets of the administration of these cases. For example:

- The Trustee negotiated a consensual Chapter 11 Plan with Mr. Varga as co-proponent.
- The Trustee managed all significant settlement conferences for the Trusts, balancing necessary risk taking with pragmatism.
- The Trustee attended interviews of key witnesses, such as Mr. Petters in Leavenworth Penitentiary in Kansas and multiple interviews of Messrs. Prevost and Harrold, including in the federal correctional institute in Englewood, Colorado.
- The Trustee attended key Rule 2004 examinations and depositions, including of GE Capital in Chicago, Illinois.
- The Trustee was deposed in the GE Capital litigation by Sean Berkowitz, Esq., Global Chair of Latham & Watkins' Complex Commercial Litigation Practice. The deposition required extensive preparation and the Trustee would have been a key witness at trial.[13]
- The Trustee met with federal law enforcement in Minneapolis on multiple occasions.
- The Trustee met regularly with Mr. Varga and his professionals to discuss status and strategy.
- The Trustee established a fair distribution structure based on § 510(b) to ensure *all* stakeholders received a distribution.
- The Trustee ensured a free flow of information to creditors via a website and periodic status letters.
- For years, the Trustee served on the Petters Committee and Petters LTC (defined below). He travelled regularly to Minnesota for meetings and hearings. The Trustee was instrumental in managing an enormous amount of complex litigation, making decisions benefitting all victims of the Petters Ponzi Scheme.
- The Trustee assumed a key role in the mediations of the major clawback claims in the Petters Bankruptcy Cases throughout the country. Together, these mediations achieved nine figure recoveries in the Petters Bankruptcy Cases in advance of the September 2020

[13] *See e.g.*, *Dietz v. Spangenberg*, 2014 WL 537753, at *3 (D. Minn. Feb. 11, 2014); *In re Louis J. Pearlman Enterprises, Inc.*, 398 B.R. 59, 66 (Bankr. M.D. Fla. 2008).

game-changing Eighth Circuit decision that potentially could have derailed most of those claims.[14] These settlements are not specified here given confidentiality restrictions.

- The Trustee assumed a key role negotiating a modification to a fee arrangement with a special counsel in the Petters Bankruptcy Cases, shifting risk onto that counsel and potentially saving the Petters estates enormous fees and costs.

- The Trustee attended the pre-negotiation for the PCI Plan mediation, reached the "Miami Accord" (described below) and led the Funds' negotiations leading to the allowance in full of the PBF PCI Claim[15] and other favorable treatment in the PCI Plan.

- The Trustee managed and supervised his professionals, including MB, Marcum LLP, and KapilaMukamal, LLP.

As Trustee in the PBF Cases and a Committee and LTC member in the Petters Bankruptcy Cases, Mr. Mukamal led the team.

III. <u>The Petters Ponzi Scheme</u>

1. From 1995 through September 24, 2008, Thomas J. Petters perpetrated the third-largest Ponzi scheme in American history, defrauding lenders of approximately $1.9 billion on a cash-on-cash basis.[16] The United States of America stipulated:

> Thomas J. Petters served as the Chief Executive Officer of [Petters Company, Inc. ("PCI")] and [Petters Group Worldwide, LLC ("PGW").] In those capacities, Thomas Petters served as an agent of both PGW and PCI, ratified the actions of PGW and PCI employees on behalf of both companies and furthered a scheme to defraud and to obtain billions of dollars in money and property by means of materially fraudulent and false pretenses, representations and promises. In general, the PCI and PGW scheme used false statements, false representations and material

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[14] *Kelley as Tr. for PCI Liquidating Tr. v. Boosalis*, 974 F.3d 884 (8th Cir. 2020). Moreover, on October 6, 2020, the Minnesota District Court entered an order granting summary judgment insulating a subsequent transferee of Arrowhead. The court found that the Petters Trustee could not avoid the initial transfer from one of the PCI consolidated debtors to a PCI investor (Arrowhead) pursuant to Section 546(e). *See Kelley v. Safe Harbor*, Case No 0:20-cv-00642-JRT at ECF No. 38. The Petters Trustee has appealed this decision.

[15] "***PBF PCI Claim***" refers to the proofs of claim filed on behalf of the Palm Beach Funds in the Petters Bankruptcy Cases. *See* Claims 35 & 36; *see also* Main Case [ECF No. 2810] par. 9.

[16] While Mr. Petters has been described as having stolen $3.65 billion through his Ponzi scheme, that figure includes fictitious profits and interest. *See e.g., U.S.A v. Prevost*, Case No. 11-141 (D. Minn.) [ECF No. 295] pg. 6. The Trustee quantifies victim losses on a cash-on-cash basis. *See e.g., In re Pearlman*, 484 B.R. 241 (Bankr. M.D. Fla. 2012).

> omissions to fraudulently induce investors to provide PCI and PGW with billions of dollars. In fact, the funds then were used (1) to make lulling payments to investors, (2) to make large payments to individuals who assisted the scheme, (3) to acquire and fund businesses owned or controlled by Thomas J. Petters, including PGW, and (4) to fund the extravagant lifestyle of Thomas J. Petters.[17]

2. Mr. Petters was a "master of deception, a chameleon, who was successful in deceiving too many smart, well-educated and successful people to count."[18] His co-conspirators included Deanna Coleman, Robert White, Michael Catain and Larry Reynolds. All pled guilty to their crimes.[19]

3. Mr. Petters deceived major political figures (including former U.S. Vice President Walter Mondale), hedge funds, individual investors, professional firms and financial institutions.[20]

4. In 2001, Frank Vennes introduced Bruce Prevost and David Harrold (the Palm Beach Funds' managers) to Mr. Petters.[21] Mr. Vennes had been convicted in 1987 of multiple federal crimes, including money laundering.[22] While incarcerated, Mr. Vennes had a religious transformation, and following his release became a major political donor, business figure, and philanthropist in Minnesota. Mr. Vennes was active in Christian ministries,[23] resulting in his introduction through a mutual friend (Pastor David Ewold) to Mr. Prevost.[24]

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[17] *U.S.A. v. PCI*, Case No. 08-364(2) (D. Minn.) [ECF Nos. 479 & 481 (Plea Agreement) and 482 & 493]; *see also In re Petters Co., Inc*., 603 B.R. 424, 427 (Bankr. D. Minn. 2019) ("The facts about Petters' Ponzi scheme are well known," and citing decisional law).
[18] Adv. Case No. 12-1979, ECF No. 537 ¶138.
[19] *U.S.A. v. Coleman*, 08-304 (D. Minn); *U.S.A. v. White*, 08-299 (D. Minn.); *U.S.A. v. Catain*, 08-302 (D. Minn.); *U.S.A. v. Reynolds*, 08-320 (D. Minn.).
[20] Adv. Case No. 12-1979, ECF No. 537 ¶¶18-26, 146, 154-57 & 182; PCI Bankruptcy Case ECF No. 3131, pgs. 18-26, 28-30; Main Case ECF No. 246, pgs. 9-10, 12-13.
[21] Adv. Case No. 12-1979, ECF No. 537 ¶27.
[22] *Vennes v. An Unknown No. of Unidentified Agents of U.S.*, 26 F.3d 1448 (8th Cir. 1994).
[23] Adv. Case No. 12-1979, Dep. of Bruce Prevost (March 15, 2016), pgs. 13-15; Main Case, ECF No. 993, ¶¶19-55.
[24] *Id.*

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5. Mr. Vennes pitched Messrs. Prevost and Harrold – themselves active in Christian causes – on the opportunity to raise and lend money to Mr. Petters. In 2002, using template documents provided by Mr. Vennes, Messrs. Prevost and Harrold created PBF I as a hedge fund to raise money from investors to lend to Mr. Petters.[25] Mr. Vennes invested the first $10 million as "seed" money for PBF I.[26]

6. In 2004, Messrs. Prevost and Harrold created PBF II to raise more money to lend to Mr. Petters.[27] On top of an equity-raise, PBF II raised debt through affiliated offshore hedge funds: Palm Beach Offshore, Ltd. and Palm Beach Offshore II, Ltd. (together, "***PB Offshore***"), which Messrs. Prevost and Harrold also managed.[28]

7. Mr. Vennes served as the middleman between the Palm Beach Funds and Mr. Petters.[29] The Funds retained Mr. Vennes' Minnesota-based lawyer, Craig Howse, Esq., to represent them (in addition to their primary legal counsel).[30]

8. From 2002 through 2008, the Palm Beach Funds raised billions of dollars from investors and financed thousands of PCI transactions.[31]

9. On September 24, 2008, federal law enforcement raided Mr. Petters, Mr. Vennes, and others ("***Raid***").[32] The Palm Beach Funds had $651 million in cash-on-cash losses.[33]

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[25] Adv. Case No. 12-1979, ECF No. 537, ¶¶51, 58.
[26] *Id.*, ECF No. 537, ¶68
[27] *Id.*, ECF No. 537, ¶¶57, 58.
[28] Main Case, ECF No. 246, pgs. 10 & 12.
[29] Main Case, ECF No. 993 ¶¶19-55.
[30] Adv. Case No. 12-1979, ECF No. 537, ¶271; Main Case ECF No. 1284 ¶6 & ECF No. 993 ¶¶19-55 & ECF No. 675 ¶6.
[31] Adv. Case No. 12-1979, ECF No. 537, ¶¶85-86.
[32] Adv. Case No. 12-1979, ECF No. 537, ¶99.
[33] PCI Bankruptcy Case, ECF No. 3131 pg. 22.

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10. Although Messrs. Prevost and Harrold were unaware of the Ponzi scheme, they made false representations to the Funds' investors from 2002 through 2008.[34] As a result, the U.S. Department of Justice ("***DOJ***") and Securities and Exchange Commission ("***SEC***") brought criminal and regulatory actions against them.[35]

11. In 2011, Messrs. Harrold and Prevost pled guilty to securities fraud and were sentenced to five and seven years in prison, respectively. They entered into consent agreements with the SEC. In 2013, Mr. Vennes pled guilty to securities fraud, receiving a fifteen year sentence.

IV. <u>The Raid Through the November 2009 Petition Date</u>

12. The Raid was followed by a flurry of insolvency proceedings and related activity:

- On October 2, 2008, the U.S.A. commenced an equity receivership under 18 U.S.C. § 1345 in the District of Minnesota against Mr. Petters, PCI, PGW and others. Douglas A. Kelley (who would later become the Petters Trustee) was appointed receiver.[36]

- Ritchie Capital (a $157 million victim) sought a different receiver in Illinois State court; this was granted on October 3, 2008.[37] A turf-battle ensued. Ultimately, the Minnesota District Court receivership (through Mr. Kelley) controlled PCI and PGW.

- Mr. Kelley as receiver filed Chapter 11 petitions for certain of the Petters entities.[38] Ritchie Capital sought to elect a trustee at the § 341 meeting and challenged the claims of the Debtors to eliminate their votes.

- MN Airlines, LLC d/b/a Sun Country Airlines (owned by a PGW subsidiary) filed for Chapter 11 bankruptcy protection in Minnesota Bankruptcy Court.[39]

- Petters Aviation, LLC (a PGW subsidiary) and its affiliate, Elite Landings, LLC filed Chapter 11 in Minnesota Bankruptcy Court.[40]

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[34] *U.S.A. v. Vennes, Prevost & Harrold*, Case No. 11-141 (D. Minn.) (Plea Agreements).
[35]*See U.S.A. v. Vennes, Prevost & Harrold*, Case No. 11-141 (D. Minn.); *S.E.C. v. Prevost & Harrold, et al*., Case No. 10-4235 (D. Minn.).
[36] *U.S.A. v. Petters et al.*, Case No. 08-5348 (D. Minn.).
[37] *See Ritchie Special Credit Investments, Ltd. v. U.S. Tr*., 620 F.3d 847, 851 (8th Cir. 2010); *United States v. Ritchie Special Credit Investments, Ltd*., 620 F.3d 824, 828 (8th Cir. 2010).
[38] *See generally*, PCI Bankruptcy Case (jointly administered); *see also In re Petters Co., Inc*., 506 B.R. 784, 789 (Bankr. D. Minn. 2013); *see also, generally, Ritchie*, 620 F.3d at 829.
[39] *In re MN Airlines, LLC*, Case No. 08-35197.
[40] *In re Petters Aviation, LLC*, Case No. 08-45136; *In re Elite Landings LLC*, Case No. 08-45210.

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- Camera and electronics companies PBE Corporation and PBE Consumer Electronics, LLC, formerly known as Polaroid Corporation and Polaroid Consumer Electronics, LLC (each a Petters-affiliate), filed Chapter 11 in Minnesota Bankruptcy Court.[41] Ultimately, John Stoebner was appointed as Chapter 7 trustee for both entities ("***Polaroid Trustee***").

- The U.S.A. sought an equity receiver in the District of Minnesota for Mr. Vennes. Gary Hansen ("***Vennes Receiver***") was appointed receiver.[42]

- Ark Discovery, a Petters-lender with cash-on-cash losses of $107 million, filed Chapter 7 in Chicago. Francis Gecker ("***Ark Trustee***") was appointed trustee.[43]

- The Lancelot Funds,[44] the largest Petters-lender with $754 million in cash-on-cash losses, filed Chapter 7 in Chicago. Ron Peterson ("***Lancelot Trustee***") was appointed trustee.[45]

- Lancelot Investors Funds, Ltd., one of the Lancelot Funds,[46] was placed into insolvency proceedings in the Cayman Islands. Mr. Varga was appointed Offshore Liquidator.

- PB Offshore entered insolvency proceedings in the Cayman Islands. Mr. Varga was appointed Offshore Liquidator.[47]

13. Mr. Varga is managing director and global head of Duff & Phelps's Offshore Restructuring practice. Duff & Phelps is the successor to Mr. Varga's prior firm, Kinetic Partners.[48] Mr. Varga was represented in the U.S. by Reed Smith, LLP, led by Edward J. Estrada.[49] Mr. Varga's local counsel was Robin J. Rubens, then a partner with Levine Kellogg Lehman

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[41] *In re Polaroid Corp., et al*., Case No. 08-46617 (jointly administered).
[42] Case No. 08-5348 (D. Minn) *See e.g., generally*, ECF No. 1762.
[43] Case No. 09-17079 (Bankr. N.D. Ill.); PCI Bankruptcy Case [ECF No. 3131, pgs. 23, 43-44].
[44] "***Lancelot Funds***" means those funds managed by Lancelot Investors Fund L.P., as described in PCI Bankruptcy Case ECF No. 3131, pg. 21.
[45] Case No. 08-28225 (Bankr. N.D. Ill.); PCI Bankruptcy Case ECF No. 3131, pgs. 21, 25-27 & 42.
[46] Main Case [ECF No. 2118 ¶¶1, 7].
[47] Neil Longbottom was appointed together with Mr. Varga as the "joint offshore liquidators." Mr. Longbottom has not been meaningfully involved in the PBF Cases.
[48] https://www.duffandphelps.com/our-team/geoff-varga
[49] https://www.reedsmith.com/en/professionals/e/estrada-edward-j

Schneider + Grossman LLP (in 2019, she joined Berger Singerman, LLP).[50] Mr. Varga was also represented by Campbells Law Firm based in the Cayman Islands.

14. After the Raid, the Funds' limited partners organized two "steering committees." In October 2008, Messrs. Prevost and Harrold transferred control to the committees.[51]

15. In October 2008, the Funds retained Fulbright & Jaworski, LLP ("***Fulbright***") as bankruptcy counsel in the Petters Bankruptcy Cases.[52]

16. On June 5, 2009, the Funds retained Lew Freeman as Chief Restructuring Officer ("***CRO***"). On November 10, 2009, Kenneth A. Welt replaced Mr. Freeman as CRO after his indictment in an unrelated matter.[53]

17. Mr. Varga and the steering committees were adversarial. They disagreed which should sit on the Petters Committee to represent "Palm Beach."[54] They disagreed over distribution priorities, with Mr. Varga asserting that the claims of all PBF II limited partners should be subordinated to PB Offshore's $718 million debt.[55]

18. In November 2008, the Palm Beach Funds sued Mr. Varga in the U.S. District Court for the District of Minnesota alleging he "*improperly and unjustifiably interfered with the rights of the [Palm Beach] Funds in the [Petters Bankruptcy Cases*]."[56] In December 2009, Mr. Varga

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[50] https://www.bergersingerman.com/team/robin-j-rubens
[51] Main Case ECF No. 10 ¶¶ 28, 29; ECF No. 81, ¶¶21-24.
[52] Adv. Case No. 12-2123, ECF No. 48 ¶¶ 20-25
[53] ECF No. 81, ¶¶35-38. This unusual twist resulted in Mr. Freeman being unavailable to consult with the Trustee regarding his activities as CRO.
[54] "***Petters Committee***" means the Official Committee of Unsecured Creditors in the Petters Bankruptcy Cases.
[55] *See generally*, Main Case, ECF No. 246 pg. 40 and ECF Nos. 3137, 3139, 3178-79.
[56] Case No. 08-6138 (D. Minn.), ECF No. 1, ¶27.

sued Messrs. Prevost and Harrold in U.S. District Court for the Southern District of Florida, alleging "*knowing and/or reckless conduct on the part of Prevost and Harrold*."[57]

19. On June 30, 2009, certain investors in PB Offshore filed a putative class action complaint against Messrs. Prevost and Harrold and others, including Kaufman Rossin & Co. ("***Kaufman***"), the auditors for both the Palm Beach Funds and PB Offshore.[58] Kaufman had a $10 million wasting[59] insurance policy.

20. The Funds (through Mr. Welt as CRO) asserted claims against Messrs. Prevost and Harrold. In November 2009, they entered into a settlement agreement ("***CRO-Insider Agreement***"). The Funds described the terms as: Messrs. Prevost and Harrold would pay a total of $5 million to the Funds' estates and cooperate in exchange for a release and a bar order.[60] This agreement proved controversial.[61]

21. On November 30, 2009, hours before the Funds filed their own Chapter 11 petitions, the Funds sued Kaufman in Miami-Dade County Circuit Court.[62]

V. <u>The Debtor-in-Possession Period of the PBF Cases</u>

22. On November 30, 2009 ("***Petition Date***"), thirteen months after the Raid, the CRO filed Chapter 11 petitions for the Debtors.[63] Although the cases have been jointly administered, the creditor bodies differ and the cases have never been substantively consolidated.[64]

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[57] Case No. 09-82398 (S.D. Fla.) ECF No. 1, ¶55.
[58] Case No. 09-21622-FAM (S.D. Fla).
[59] "Wasting" in that Kaufman's defense fees would deplete available coverage.
[60] *See e.g.*, Main Case ECF No. 34, ¶¶3-6.
[61] *See e.g.*, Main Case ECF No. 34, ¶¶3-6.
[62] Case No. 09-86048 CA 30 (11th Judicial Cir. in and for Miami-Dade County, Florida).
[63] ECF No. 81, ¶8.
[64] ECF No. 48 and 19 in PBF II.

23. The Debtors moved to retain (i) Berger Singerman, LLP as Debtors' bankruptcy and general counsel to be paid on an hourly basis;[65] and (ii) two law firms as Debtors' special litigation counsel to be paid on a contingency fee basis ("***Debtor-Proposed Contingency Counsel***").[66] The proposed fee would be 40% of all gross recoveries from any source, including future distributions from the Petters Bankruptcy Cases.

24. The Funds' disputes with Mr. Varga immediately moved to this Court.

25. Mr. Varga, and the Office of the U.S. Trustee, sought conversion to Chapter 7 or appointment of a Chapter 11 trustee. Mr. Varga objected to the proposed professional retentions[67] and lamented the estates' inability to pay hourly professionals or costs: [68]

- "*The Debtors are currently not operating and have not operated for over a year*"
- "*The Debtors are administratively insolvent*"
- "*Indeed, what little cash may exist in the Debtors' accounts has been frozen*"
- "*These cases concern entities with no business operations, no employees, no tangible assets and no prospects for reorganization*"
- "*[T]he ability to pay the Professionals is questionable at best*"
- "*[T]here are no tangible assets, much less cash, in the estates with which to compensate the Professionals*"
- "*[T]he Debtors' Schedules and Statements of Financial Affairs ('SOFA'), offers no clue as to how, on a monthly basis, the Debtors will pay the Professionals for any services rendered"*

26. In addition, Mr. Varga and the Office of the U.S. Trustee questioned the adequacy of the CRO-Insider Agreement, even though the steering committees supported the agreement.

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[65] ECF No. 6.
[66] ECF Nos. 7 & 11.
[67] *See generally* ECF Nos. 34, 44, 54, 66, 67, 76 & 81.
[68] ECF No. 68 ¶¶ 6, 12, 13, 19-21.

The Chair of the steering committees, Neal Greenberg, who signed the agreement, was later charged by the SEC with fraud in the management of his own hedge funds.[69]

27. The $5 million proposed payment consisted of two components: (i) $3 million in cash; and (ii) $2 million in securities. Of the $3 million in cash: (i) $734,501.77 was in the form of a credit for fees the insiders previously paid their defense counsel; (ii) $150,000 was in the form of a credit for undescribed expenses the insiders previously funded; and (iii) $1,115,498.23 would be paid to the insiders' counsel as a nonrefundable retainer for future attorneys' fees. Thus, only $1 million would be paid to the estates, with those monies to pay contingency fees and retainers to the Debtors' professionals.

28. The $2 million in securities were equity positions in defunct hedge funds managed by Messrs. Prevost and Harrold.[70] The $2 million figure was based on the net asset value of those funds thirteen months earlier. The equity positions had no true value.

29. The Office of the U.S. Trustee asserted: [71]

- *"Of the $3 Million cash, all is being used to fund professionals and attorney's fees*;"
- "*[T]he [CRO-Insider Settlement Agreement] does not result in any funds being paid to the estate. The creditors will not receive anything in return for this [agreement]*."
- "*[F]unds are scarce*;"
- "*[T]here is no confidence in the Debtor*;"

Mr. Varga argued similarly.[72]

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[69] *See* https://www.sec.gov/litigation/admin/2010/33-9139.pdf and https://www.sec.gov/litigation/litreleases/2012/lr22291.htm.
[70] The interests were in Palm Beach Diversified Income LP, Palm Beach Multi-Strategy Fund LP, and Palm Beach Strategic Income LP.
[71] ECF No. 34; *see also* ECF No. 81 ¶¶36-37.
[72] ECF No. 67 ¶¶3, 32-34 & n. 9.

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30. On January 28, 2010, the Court entered its Order Directing Appointment of Chapter 11 Trustee. On January 29, 2010, the Office of the U.S. Trustee appointed the Trustee as Chapter 11 trustee for each of the estates.[73] On February 4, 2010, the Trustee filed his motion to retain MB as his general counsel, which this Court granted.[74]

VI. The State of Affairs in February 2010

31. When the Trustee was appointed:

- The Debtors had no money[75] to fund costs, experts or the Trustee's professionals.[76]
- There had been over a year of stakeholder infighting and distrust between (i) the controlling equity holders, the CRO and his professionals; and (ii) PBF II's largest creditor (Mr. Varga on behalf of PB Offshore).
- Messrs. Prevost and Harrold expected the Trustee to seek this Court's approval of the CRO-Insider Agreement. The Trustee viewed the consideration as inadequate and was unwilling to do so, resulting in early friction with Messrs. Prevost & Harrold.
- The Debtors had sued M&I Bank and U.S. Bank with pleading deficiencies and no Rule 2004 discovery. The banks exploited this in their motions to dismiss.
- The Debtors sued Kaufman hours before the bankruptcy filing with no Rule 2004 discovery. Kaufman's $10 million insurance policy was a "wasting" policy and Kaufman faced three other suits by Mr. Varga, a PB Offshore putative class and a limited partner of the Debtors.
- The criminal and regulatory exposure for Messrs. Prevost, Harrold and Vennes exposed the Trusts to "causation" and equitable defenses (*e.g.*, *in pari delicto* and unclean hands).[77]

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[73] ECF Nos. 100 and 107; see also ECF No. 81.
[74] ECF Nos. 115 & 121.
[75] Joint Stipulation of Facts between the Office of the U.S. Trustee, Mr. Varga and the Debtors, ECF No. 81 at ¶13: "*The Debtors have no available cash and have not opened debtor-in-possession bank accounts.*"
[76] ECF No. 81 ¶¶6, 12 & 13; ECF No. 44, ¶9; *see also* ECF No. 68 ¶ 13; ECF No. 44, n.11 identifies pre-petition retainers provided to Berger Singerman and Mr. Welt. Following his appointment, the remaining unused portion of these retainers were turned over to the Trustee, but only after resolving Messrs. Prevost and Harrold's assertions that they were entitled to this money. *See e.g.* ECF No. 153.
[77] *See e.g.*, *Trustee v. GE Capital*, Adv. Case No. 12-1979 [ECF No. 68] (Answer & Affirmative Defenses), pg. 2 ("*The responsibility for the losses suffered by the Palm Beach Funds rests squarely on the shoulders of the principals of the Palm Beach Funds, Petters, and Frank Vennes,*

Litigation targets asserted that Mr. Petters did not defraud the Funds, but rather the Funds were complicit or at a minimum did not sufficiently rely on Mr. Petters' lies. Messrs. Prevost and Harrold's convictions presented enormous challenges to the pursuit of tort claims and allowance of the PBF PCI Claim.

- The willingness of Messrs. Prevost, Harrold and Vennes[78] to cooperate, as well as the value of their cooperation, was impacted by civil actions and the potential for criminal and regulatory actions.

- The delay from October 2008 through November 2009 in placing the Debtors into bankruptcy essentially truncated Chapter 5 clawback claims. While the Funds had transferred tens of millions of dollars to limited partners in the months prior to the Raid, the delay in filing bankruptcy resulted in none of those payments qualifying as § 547 90-day or one-year preferences. The two- and four-year look back periods under §§ 548 and 544 effectively became one- and three-year look back periods.[79] Typically, § 547 recoveries are "lower-hanging fruit." In these cases, tens of millions of dollars in avoidance claims that might otherwise have been available were all lost.

- The Trustee faced disputes with creditors in the Petters Bankruptcy Cases that had objected or expressed an intent to object to the PBF PCI Claim.

- The Palm Beach Funds had failed to secure a seat on the Petters Committee, leaving them no meaningful role in the administration of the Petters Bankruptcy Cases and privy only to public information.

VII. <u>The Trustee's Initial Strategy and MB's Fee Arrangement</u>

32. The Trustee and MB developed a comprehensive approach based on the notion that any factual or legal position taken in one aspect of the case (whether in litigation in this District or the Petters Bankruptcy Cases) could impact other aspects of the case. Internally, this was described as "*everything touches everything*."

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all of whom … have been criminally prosecuted and … convicted of criminal conduct in connection with their roles in these losses. Indeed, as they have acknowledged in connection with their guilty pleas to federal criminal charges, the Palm Beach Funds' principals – David Harrold and Bruce Prevost – obtained the very money the Funds invested (and lost) by criminally defrauding their own investors."); & pg. 78; [ECF No. 510], pgs. 44-50.

[78] For example, before Mr. Vennes' conviction, MB met with Mr. Vennes and his counsel in Minneapolis. Mr. Vennes' counsel required MB and Mr. Vennes to sit in separate rooms with Mr. Vennes' counsel shuffling between the two rooms relaying questions and answers, depriving MB of direct access to a material witness.

[79] *See e.g.*, 11 U.S.C. §§ 544, 547, 548, 550 and § 726.109, Fla. Stat.

33. The Trustee and MB generally organized matters in the following categories:

(1) Administration and corporate governance of the PBF Cases;

(2) The Funds' litigation claims; and

(3) The Petters Bankruptcy Cases and the PBF PCI Claim.

34. Mr. Varga had previously obtained expensive private litigation financing approved by the Cayman Court in the PB Offshore case and suggested the possibility of the Trustee obtaining financing. The Trustee declined, resulting in the professionals assuming the risk that the Debtors could pay professionals only if successful in the underlying litigation. Given the lack of funds in the estates, payment of MB's hourly fees was at risk. MB was not paid any fees or reimbursed for any costs from its retention in February 2010 until the Kaufman settlement was approved as part of the PBF Plan that was confirmed in October 2010 and effective in November 2010.[80] MB would only be paid, even for administrative work and the hourly portion of its hybrid compensation, if successful in litigation.

35. From inception, the PBF Cases were pure litigation cases. There were no physical assets to administer. Given the inadequate resources to pay professionals to pursue complex actions, and the expected significant costs for experts, travel, transcripts, and document management, the Trustee and Mr. Varga negotiated a comprehensive alternative-fee arrangement to ensure MB's compensation would be performance-based, with rewards for success. This would shift financial risk onto MB as the Trustee's counsel that would invest the most resources.[81] Mr. Varga was a highly sophisticated party during these negotiations. The fee structure provided for:

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[80] ECF No. 307.

[81] ECF No. 193 ¶11 ("*Perhaps more significant, the Trustee does not believe that the estates should bear the sole financial risk relative to the outcome of the litigation to be pursued and that it is appropriate for counsel to be paid a reduced hourly rate coupled with a partial contingency component*.").

(1) hourly fees for matters of case administration, such as plan confirmation;

(2) hybrid fee arrangement (75% of hourly rates plus a 10% contingency fee) for investigation and prosecution of all third-party litigation claims; and

(3) hourly fees to prosecute the PBF PCI Claim and pursue the Debtors' interests in the Petters Bankruptcy Cases.[82]

Moreover, because pursuing allowance of the PBF PCI Claim was essentially a contested litigation matter and it was "*impossible to identify the timing or quantify the amount of any eventual distribution*,"[83] the Trustee, Mr. Varga, Reed Smith, and MB discussed a hybrid fee arrangement for MB's work related to the Petters Bankruptcy Cases. Instead, they agreed:

> [MB] shall charge 100% of its hourly rates for all … services associated with the Petters Bankruptcy Cases… However, depending on the outcome and results achieved in connection with the Debtors' cases, including the results of and amounts of distributions from the Petters Bankruptcy Cases, [MB] shall be entitled to seek additional fees based on the results achieved, subject to application and approval by the Court.[84]

(together, the "***MB Fee Arrangement***").

36. Although a rigid formula was not selected, the intent was to incentivize MB with the opportunity for meaningful additional compensation based on performance, with an emphasis on the outcome and recoveries in the Petters Bankruptcy Cases.

37. The MB Fee Arrangement was noticed to all parties-in-interest, approved by Court Order, and ratified in the PBF Plan confirmed by this Court.[85]

38. In 2011, the Court modified the MB Fee Arrangement based on a request that emanated from Mr. Varga. The Trustee required Mr. Varga's consent as Trust Monitor to

[82] ECF Nos. 193, 223 and 2197.
[83] ECF No. 193 ¶10.
[84] ECF No. 193 at ¶ 20.
[85] ECF Nos. 193 at ¶¶ 20, 223, 245 at pg. 33, 444.

commence a litigation matter for the PBF II Trust.[86] Mr. Varga concluded that the Funds' potential claims against GE Capital Corp. ("***GE Capital***") were not worth pursuing. Therefore, he withheld consent to MB incurring fees on a hybrid basis to investigate and potentially sue GE Capital.[87] As a result, MB agreed to do so on a pure contingency fee basis, assuming substantial risk. Mr. Varga also requested that any litigation against U.S. Bank, N.A. be brought on a pure contingency fee basis. MB agreed to this as well.

VIII. Administration of the PBF Cases and the PBF Plan

39. The Trustee, MB, Mr. Varga, Robin Rubens, and Ed Estrada quickly developed a productive working relationship. Mr. Estrada was closely involved in all facets of the administration of the cases until Mr. Varga sold his claim in 2013. The group held weekly Friday morning calls and met regularly in-person in South Florida, New York or Minneapolis.

40. To provide visibility to stakeholders, the Trustee and MB created and maintained a website ("***Website***"),[88] posting significant court papers such as the PBF Plan, fee applications, adversary complaints, and settlement motions. The Trustee and MB sent regular status letters to stakeholders, sharing important information while protecting confidential work product. MB spoke by telephone regularly with numerous stakeholders and their counsel, and met some in-person.

41. To ensure accountability, each financial quarter the Trustee's accountants updated an internal schedule of aggregate recoveries and expenses, referred to colloquially as the "***Report Card***." Because certain data is subject to confidentiality restrictions, MB will seek to file under seal the version through December 31, 2020.

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[86] ECF Nos. 802 & 815.
[87] ECF No. 3588 ¶8.
[88] www.palmbeachfinanceinfo.com.

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42. On July 26, 2010, the Trustee and Mr. Varga proposed a Chapter 11 Plan ("***PBF Plan***").[89] With overwhelming creditor support, the Court confirmed the PBF Plan by Order dated October 21, 2010, less than nine months from the Trustee's appointment and MB's retention.[90]

43. At the October 19, 2010 confirmation hearing, the Bankruptcy Court stated to MB: "*[y]ou did an excellent job, your firm did*." And the Office of the U.S. Trustee followed up, stating: "*Your Honor, Heidi Feinman for the U.S. [T]rustee. I just want to again thank counsel. You [the Court] already did. I think they did a great job and the [T]rustee did a great job …*".[91]

44. The PBF Plan resulted in, among other things:

- Creation of the Trusts to pursue recoveries.
- Liquidation of Mr. Varga's claim ("***Varga PBF Claim***") in PBF II for the benefit of the victims of the Petters Ponzi Scheme that invested through PB Offshore.
- Apportionment of expenses and recoveries via the "*Pro Rata Allocation Formula*" given the two estates were not consolidated.
- Corporate governance, including:
  - The Trustee's role as the estates' senior fiduciary.
  - Mr. Varga's junior fiduciary role as "Trust Monitor." Essentially, Mr. Varga served as a committee-of-one to oversee the cases. To facilitate this role:
    - Mr. Varga was given confidential information, including work-product, under a common-interest privilege. He and his professionals would be inside the Trustee's "tent."
    - The Funds would pay Mr. Varga's fees as well as those of his legal and financial professionals.

[89] ECF Nos. 191 & 192.
[90] ECF Nos. 245, 410 & 444.
[91] October 19, 2010 Hearing Tr., pg. 21. The Bankruptcy Court continued, stating: "*And, frankly, this case worked the way Chapter 11 is supposed to work, and I want to compliment everyone for making sure that occurred." Id.*, pg. 24.

- Mr. Varga's consent was required for PBF II to enter into a settlement with any litigation targets.

45. With corporate governance in place for the Debtors that had been riddled with infighting and litigation since the Raid, the Trustee and MB could turn to investigation and pursuing recoveries. Confirmation of the PBF Plan was an enormous achievement given the state of affairs when the Trustee was appointed.

IX. In September 2013, Mr. Varga Concludes the Financial Risks are "Untenable"

46. Section X describes the major sources of recoveries through the years. Before doing so, this Section discusses Mr. Varga's decision in September 2013 to sell his claims.

47. Before Mr. Varga's appointment in October 2008, PB Offshore was managed by Messrs. Prevost and Harrold. Upon his appointment as liquidator for PB Offshore, Mr. Varga became a fiduciary charged with maximizing the recovery to PB Offshore's investors. Those investors invested hundreds of millions of dollars as limited partners in PB Offshore, which loaned that money to PBF II, which loaned (and lost) that money to Petters. The Varga PBF Claim was their primary, if not exclusive, source of recovery.

48. By November 2011, the Trustee filed most of his litigation claims.

49. From 2010 through 2013, the Trusts paid Mr. Varga (as Trust Monitor) and his professionals over $6.3 million. As Trust Monitor, he was well situated to understand the Trusts' recovery prospects. He was privy to the Trustee's non-public investigatory work product. And as liquidator for one of the Lancelot Funds, he was privy to confidential information from Trustee Peterson.

50. Mr. Varga informed the Cayman Court that PB Offshore's "primary asset" was the Varga PBF Claim. Through his multiple roles, Mr. Varga understood the claim's value. He was aware of the risks the Trustee faced in the litigation filed in this Court and the need to fund many

experts. He was also aware of the risks the Trustee faced to get the PBF PCI Claim allowed, including after an unsuccessful concerted push in early 2012. Mr. Varga also understood the risks and challenges that the PCI estate faced in attempting to generate recoveries.

51. By September 2013, Mr. Varga determined that the value of the PBF Varga Claim was outweighed by the risks and expense of continuing to administer PB Offshore. He was unwilling to continue to administer PB Offshore because PB Offshore would only be able to pay his fees as liquidator if the PBF II Trust would be able to make a distribution to PB Offshore on account of the PBF Varga Claim.[92]

52. In his 8th Report to his constituency, Mr. Varga stated he had examined the Trustee's litigation, the prospects for PBF II Trust, the PBF II Trust's 2013 Q3 cash position ($3,049,806)[93] and the ongoing fees and expenses that he expected the PBF II Trust to incur to prosecute its ongoing litigation. Mr. Varga concluded that the risks were "***untenable.***"[94]

53. Mr. Varga advised the Cayman Court that he engaged in a fulsome marketing process to ensure he received fair value for the Varga PBF Claim, his estates' primary asset. He understood that the price he received would be the primary recovery for the crime-victims whose interests he was charged with protecting and who had lost hundreds of millions of dollars.

54. After approaching at least ten potential buyers and receiving several offers, Mr. Varga sought and received approval of the Cayman Court to "sell"[95] the Varga PBF Claim to

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[92] *See* https://micro.duffandphelps.com/caymanrestructuring/cases?caseId=1172, which contains a link to Mr. Varga's September 10, 2013 eighth report to creditors and contributories ("***Mr. Varga's 8th Report***"). Mr. Varga states in part: "In circumstances where *the JOLs are no longer able to pay* their advisers (or *themselves)*, it *has become untenable* to continue to prosecute the Offshore Funds' claims and/or participants in the PBF II Liquidating Trust." (emphasis added).
[93] *See* ECF No. 60 in Case No. 09-36396.
[94] *See* Mr. Varga's 8th Report.
[95] It was not a traditional sale, but the transfer of 100% of a beneficial interest.

Stonehill Master Fund, Ltd. ("***Stonehill***" or the "***Participant***") for $16 million.[96] Stonehill was the "highest and best bid."[97]

55. Ultimately, it appears that Mr. Varga distributed under $600,000 to the PB Offshore investors, who collectively lost well over half a billion dollars.[98]

56. Since October 1, 2013, the Trustee and MB went on to recover roughly $200 million of the aggregate $229 million in recoveries. Including the pending fourth interim distribution, the majority of these $200 million in recoveries – $111,850,200 – will have been paid to Stonehill, the purchaser and holder of the PBF Varga Claim. Certainly, Mr. Varga would not have sold his claim if he had a reasonable expectation in September 2013 that the Trustee and MB could deliver this type of outcome for the benefit of the PB Offshore investors.

X. <u>The Debtors' Litigation Claims</u>[99]

A. <u>Kaufman Rossin</u>

57. Within weeks of its retention, MB commenced negotiations with the Kaufman Rossin public accounting firm to prevent the continued diminishment of the policy from defense costs from the three pending actions. An in-person settlement conference with Kaufman's senior management, the Trustee and MB (without a mediator) resulted in a settlement for $9.6 million,

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[96] *See e.g.*, Mr. Varga's 8th Report, pg. 9; *see also* Main Case ECF Nos. 2118, 2161, 3467. However, Mr. Varga's 14th Report, pg. 15, reflects PB Offshore received only $9.8 million.
[97] ECF No. 2118-1, ¶5.1
[98] *See* Mr. Varga's August 9, 2016 14th Report.
[99] MB maintains a time category entitled "Litigation." This category includes situations for which a specific litigation file may not have been established, typically because an adversary was not filed and the matter was settled pre-suit. This category also includes time attributable to multiple litigation matters but not easily allocable. Examples include status meetings with Mr. Varga and his professionals, interviews of former insiders of the Debtors or PCI, review of the Debtors' records, common research issues, and so forth. Fees were charged in this category at 75% of rates and the total amount paid during the life of these cases is approximately $1,789,113.

an amount that exceeded remaining policy limits. The settlement was incorporated into the PBF Plan.

58. While MB negotiated the entire $9.6 million settlement with Kaufman, MB agreed to seek a 10% contingency fee on only a portion of the full settlement amount, as the majority of the settlement would be paid to Mr. Varga on account of independent claims he held against Kaufman and in consideration of other concessions Mr. Varga made as part of the Plan process. MB was paid reduced hourly fees of $138,245.40 and a contingency fee of $369,600.

59. The settlement also resolved the two other claims brought against Kaufman. This result was achieved without the expense of formal discovery or a testifying accounting expert.

60. As described above, Lancelot was the largest creditor of the Petters Bankruptcy Cases and filed bankruptcy in Chicago. The Lancelot Trustee sued the Lancelot funds' pre-petition accountants and lost due to *in pari delicto* based on the Lancelot funds' manager's misconduct.[100]

61. While the Kaufman settlement provided the Trusts their first recoveries, Mr. Varga and his professionals received over $1.25 million in § 503(b) administrative claims for their efforts seeking the Trustee's appointment and pursuing the PBF Plan together with the Trustee.[101]

B. <u>Claims against Messrs. Prevost and Harrold</u>

62. The Trustee and MB performed financial due diligence to determine how much Messrs. Prevost and Harrold received in compensation, how the money was spent, and what assets remained. Given certain post-*Madoff* changes in federal tax laws, the investigation included assessing Messrs. Harrold and Prevost's rights to income tax refunds, which proved valuable.

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[100] *See Peterson v. McGladrey & Pullen, LLP*, 676 F.3d 594 (7th Cir. 2012); *Peterson v. McGladrey LLP*, 792 F.3d 785 (7th Cir. 2015).
[101] *See* ECF Nos. 552, 553 and 554.

63. The Trustee and MB sought to avoid suing Messrs. Prevost and Harrold since doing so might compromise the Trustee's other litigation claims or the PBF PCI Claim and their cooperation was important.

64. The Trustee and MB negotiated settlement agreements with Messrs. Prevost and Harrold, whereby each turned over: (i) a substantial percentage of their assets; and (ii) the bulk of their future tax refunds (Messrs. Prevost and Harrold retained an interest to incentivize them to pursue the refunds).

65. The Trustee recovered over $6.5 million from Messrs. Prevost and Harrold, including from their homesteads, tax refunds and transferees.[102] By contrast, under the CRO-Insider Agreement, the estates would have received no tangible recovery.

66. MB was paid reduced hourly fees of $247,523.25 and contingency fees of $641,102.25.

C. Claims Against M&I Bank and US Bank

67. Before the Trustee's appointment, the Debtors filed an adversary complaint against M&I Bank and US Bank, and both banks moved to dismiss.[103] Given the need to identify actionable facts, MB negotiated with the banks to dismiss the complaint without prejudice, allowing the Trustee to take Rule 2004 discovery.

1. M&I Bank n/k/a BMO Harris Bank

68. M&I Bank was Petters' primary depository institution, through which Petters perpetrated the Ponzi Scheme. Over $40 billion moved through a single checking account ("***PCI Account***") in a branch in a Minneapolis suburb from 2001 through 2008.

[102] ECF Nos. 501, 532, 546, 547, 551, 604, 621, 631, 660, 730, 757, 1035, 1764 & 2336.
[103] Case No. 09-2530 [ECF Nos. 9 & 18].

69. Beginning in October 2010, MB examined M&I Bank under Rule 2004. M&I Bank claimed it could not designate a witness to testify on the "sources and uses" of monies in the PCI Account. M&I Bank's Milwaukee-based lead counsel (Godfrey & Kahn S.C.) represented on the record: "*this is because there's no one at M&I who would have any information to testify on that subject*..."

70. Through Rule 2004 discovery, MB developed facts to support a meritorious claim.

71. Pre-suit, the Trustee and MB shared a draft complaint with M&I Bank to initiate a dialogue. On July 1, 2011, Godfrey & Kahn, a large mid-west law firm, responded with a blistering letter accusing MB of manufacturing facts and threatening a Rule 9011 motion if the Trustee filed suit. *See* **Exhibit 1**. The intent appeared to be to intimidate the Trustee and MB to stand down.

72. On November 28, 2011, the Trustee sued M&I Bank. After extensive motion practice, the Court denied (in part) M&I's motion to dismiss and fact discovery began. The parties exchanged millions of pages and had multiple discovery disputes and contested hearings.

73. Through discovery in the adversary,[104] MB learned that multiple trained M&I Bank Anti-Money Laundering analysts had received account alerts ("***AML Alerts***") triggering them to investigate, including studying the sources and uses of money many times from 2005 through 2008. A Godfrey & Kahn attorney performed the first investigation in 2005. Based on this discovery, the Trustee amended his complaint and filed a second one in September 2014.[105]

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[104] *See e.g.* Adv. Case No. 11-3015 ECF Nos. 132 and Plaintiff's Motion for Leave to File Second Amended Complaint (under seal) dated June 13, 2014, granted at ECF No. 252.
[105] *See* Adv. Case 14-01660 ECF No. 1.

74. In 2015, two years after Mr. Varga sold his claim because of the risk to his ability to collect fees, the Trustee and MB recovered $16 million from M&I Bank's successor, BMO Harris Bank.[106]

75. In 2018, the U.S. DOJ fined M&I Bank $10 million, upon information and belief, based on facts uncovered by the Trustee.[107] The DOJ's public statement states in part:

> This significant civil penalty underscores the Department of Justice's continued commitment to use all of the tools at our disposal to hold accountable financial institutions that participate in wrongful activity.

76. In 2019, following an evidentiary hearing, the Minnesota Bankruptcy Court found that M&I Bank "intentionally destroyed" evidence and knowingly provided the Trustee a false sworn interrogatory response in the litigation.[108]

77. The Trustee then mediated with M&I Bank and in 2020 reached an agreement for the bank to pay an additional $800,000 to resolve any associated additional liability.

78. MB was paid reduced hourly fees of $3,144,398.28 and contingency fees of $1,360,000. MB's co-counsel (Mandel & Mandel LLP) was paid reduced hourly fees of $829,539.67 and a contingency fee of $320,000.

79. None of the $16.8 million gross recovery would have been realized had the Trustee and MB ceded to M&I Bank's Rule 11 threats in July 2011.

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[106] Main Case ECF Nos. 2670, 2689.
[107] https://www.justice.gov/usao-edca/pr/bmo-harris-bank-pays-10-million-resolve-fraud-allegations.
[108] Case No. 12-4288 (U.S.B.C. for the D. Minn.) ECF No. 353, pgs. 11 & 44.

2. US Bank

80. US Bank maintained the custodial and escrow accounts for the Palm Beach Funds, based on a contractual relationship. In addition, PB Offshore had its own separate depository and contractual relationships with US Bank.

81. After dismissing the Debtors' initial complaint against US Bank without prejudice, at Mr. Varga's request, MB's retention was converted to a pure 33% contingency.

82. MB examined two bank officers pursuant to Rule 2004. Based on their investigation, the Trustee and MB determined that any claim faced significant legal and factual challenges.

83. As a result, the Trustee engaged US Bank in settlement discussions and participated in a mediation in March 2012 in Minneapolis. Mr. Varga attended the mediation and asserted that PB Offshore held an "independent claim" against US Bank based on PB Offshore's contractual agreements. The Trustee and MB believed Mr. Varga's claim was also legally and factually challenged.

84. Settlement discussions continued after the mediation and ultimately, in August 2012, the Trustee and MB settled with US Bank for $1.7 million.[109] MB was paid a contingency fee of $561,000 out of the $1.7 million recovery.

85. Mr. Varga did not settle his independent claim. Instead, he sued US Bank in Minnesota District Court. His complaint was dismissed and the Eighth Circuit Court of Appeals affirmed.[110] Mr. Varga received no recovery, paid at least $308,583 to his legal counsel,[111] and US Bank asserted a contractual right against PB Offshore for its defense fees.

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[109] Main Case ECF Nos. 1368 & 1424.
[110] *Varga v. U.S. Bank Nat. Ass'n*, 764 F.3d 833 (8th Cir. 2014).
[111] Varga's 8th Report dated September 10, 2013 at Appendix A, note 3.

D. General Electric Capital Corporation

86. In 2010, in reviewing the transcript of Thomas Petters' 2009 criminal trial, MB realized that two GE Capital employees had testified as witnesses for the U.S.A. Mr. Petters claimed that others at his companies, Deanna Coleman and Robert White, had perpetrated the fraud without his knowledge. The U.S.A. called the GE Capital witnesses to explain that they had dealt directly with, and confronted, Mr. Petters.

87. MB reviewed the testimony and evidence and interviewed witnesses such as Ms. Coleman and Mr. White. MB sought to determine what GE Capital learned and when, and to better understand the overall Petters-GE Capital relationship. When Mr. Varga withheld his consent to PBF II continuing its investigation on a hybrid fee basis, MB proceeded on a contingency fee basis.

88. MB noticed GE Capital for a Rule 2004 examination in Chicago. GE Capital moved for protection and after a contested hearing, this Court permitted the examination to proceed.[112] The examination enabled the Trustee to uncover the facts necessary to plead a claim for civil conspiracy to commit common law fraud, highlighting the value of Rule 2004 in financial fraud cases where trustees are after-the-fact fiduciaries who must investigate what occurred years earlier.

89. On September 29, 2012, the Trustee sued GE Capital. While the Court dismissed certain claims, the Court denied GE Capital's request to dismiss the civil conspiracy claim.

90. Thereafter, the third, fourth and fifth-biggest creditors in the Petters Bankruptcy Cases – Ark Discovery, Ritchie and Greenpond as successor to Acorn – filed copy-cat suits against GE Capital. [Greenpond is owned by Stonehill Capital, which in November 2013 acquired Mr. Varga's claims against PBF II.]

[112] ECF Nos. 1093, 1119, 1121, 1154, 1170, 1280, and 1299.

91. All three copy-cat plaintiffs' suits were dismissed at the motion-to-dismiss stage. Each court accepted GE Capital's argument that the plaintiffs lacked "standing." Two of the copy-cat plaintiffs appealed and both decisions were affirmed on appeal.[113] These five decisions created significant legal challenges to MB's prosecution of the Funds' claim and emboldened GE Capital as the Trustee was subject to the same standing argument.

92. Despite the rulings in the copy-cat cases, MB continued with discovery, a massive undertaking. The parties exchanged millions of documents and took over 70 fact and expert depositions in cities and prisons across the country. MB developed extensive evidence to cause GE Capital to concede at summary judgment that there was adequate record evidence to present a question of fact for a jury to determine whether GE Capital learned of the Petters Ponzi Scheme and joined as a co-conspirator.[114]

93. The Trustee and MB successfully opposed GE Capital's summary judgment motion, including the challenge to the Trustee's "standing."[115] While this issue was fully briefed on interlocutory direct appeal to the Eleventh Circuit Court of Appeals, GE Capital agreed to pay $49 million. The Trustee achieved this recovery despite the impact of the adverse rulings in the copy-cat cases on his negotiating leverage.

94. When Mr. Varga sold his claim, the GE Capital adversary had been pending for a year and the Court had already ruled on GE Capital's motion to dismiss.[116] MB continued to litigate for more than five years after Mr. Varga determined the financial risk to his firm was "*untenable*."

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[113] *Gecker v. GECC*. 2015 WL 5086398 (N.D. Ill. July 27, 2015); *Ritchie Capital Mgmt., L.L.C. v. GECC*, 121 F.Supp.3d 321 (S.D.N.Y. 2015), *aff'd*, 821 F.3d 349 (2d Cir. 2016); *Greenpond S., LLC v. GECC*, 886 N.W.2d 649, 651 (Minn. Ct. App. 2016) (review denied).
[114] Adv. Case No. 12-1979, ECF No. 538.
[115] *In re Palm Beach Fin. Partners, L.P.*, 568 B.R. 874 (Bankr. S.D. Fla. 2017).
[116] *See* ECF 56 in GE Adversary Case No. 12-01979, dated August 23, 2013.

95. MB absorbed tremendous financial risk investing roughly $12 million in hourly time from 2011 through 2019. In 2019, MB received a contingency fee of $14,210,000. Co-counsel Kozyak Tropin & Throckmorton, P.A. and Mandel & Mandel LLP received $2,940,000 and $1,470,000, respectively. Expert witness fees totaled approximately $3,540,000. The "net profit" to the estate is estimated at approximately $26,840,000, less other costs and expenses.

96. None of the three copy-cat plaintiffs received any recovery, including Stonehill through its affiliate Acorn.

E. <u>The Funds' Pre-Petition Attorneys</u>

97. Pre-petition, the Funds retained three law firms. The Funds' primary counsel was Sims Moss Kline & Davis LLP ("***Sims Moss***") based in Atlanta. The firm specialized in representing hedge funds and provided a range of professional services for the Funds. Howse and Thompson, P.A. is a Minneapolis-based law firm that represented Mr. Vennes. To have "eyes and ears" on the ground in Minneapolis, the Funds retained the Howse firm as well.

98. Shortly after they were created, the two steering committees caused the Funds to retain Fulbright & Jaworski LLP[117] ("***Fulbright***") to represent the Funds.

99. MB asserted claims against, and settled pre-suit with, Howse & Thompson for $1,225,000 and Sims Moss for $2,750,000.[118] Both settlements included cooperation provisions essential to the Funds' other claims.

100. On October 16, 2008, the Palm Beach Funds retained Fulbright to represent their interests in the Petters Bankruptcy Cases. Notably, Fulbright was not retained to counsel the Palm Beach Funds whether to file their own bankruptcy; for example, to preserve Chapter 5 avoidance

[117] Today Fulbright is known as Norton Rose Fulbright US LLP.
[118] ECF Nos. 675, 753, 1284 and 1347. The Trustee settled with Sims Moss in July 2011 and Howse & Thompson in June 2012.

claims. MB developed a novel claim based on the unique facts that this issue should have been "readily apparent" to Fulbright and therefore the firm had a duty to advise the Funds about the benefits of filing their own bankruptcy cases.[119] The damages would be the value of the Chapter 5 claims that would have been available had the Palm Beach Funds filed petitions in the fall of 2008.

101. This theory required the Trustee to establish he would have prevailed in each hypothetical avoidance action (case-within-a-case), taking into account statutory defenses including § 546(e). In August 2014, after defeating a motion to dismiss and engaging in discovery, the Trustee and MB reached a settlement with Fulbright.[120]

102. In total, MB recovered $10,225,000 from these three law firms and was paid reduced hourly fees of $931,492.36 and contingency fees of $1,022,000.

103. Moreover, Fulbright waived its claim (scheduled by the Debtors as "undisputed") of $750,000 for unpaid fees.[121] Based on the first three distributions and the upcoming fourth distribution, Fulbright would have received a recovery of over $225,000. MB did not seek a fee based on this savings to the estates.

F. <u>Limited Partners</u>

104. While the Debtors had no preference claims, they did hold fraudulent transfer claims against certain former limited partners to disgorge cash-on-cash profits.

105. The Trustee and MB established uniform parameters and consensually resolved all claims despite the assertion of defenses such as under § 546(e). The use of a uniform settlement

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[119] Adv. Case No. 12-2123-PGH [*See e.g.*, ECF No. 25].

[120] ECF No. 2377. The settlement amount is public. However, paragraph 9 of the settlement agreement restricted the Trustee from disclosing the amount in the body of the Rule 9019 motion itself, requiring instead a reference to the settlement agreement. While MB does not believe this contractual provision prohibits stating the amount in this Motion, in an abundance of caution MB does not do so. The settlement amount is available at ECF No. 2377 pg. 9 of 32.

[121] ECF Nos. 2377 and 2417.

percentage encouraged settlements because each party was assured of obtaining the "same deal," absent evidence of incapacity to pay.

106. MB recovered $9,401,745 and was paid reduced hourly fees of $870,907 and contingency fees of $919,553. In addition, in January 2021, a settlement for $115,000 was reached with a final avoidance target.[122]

G. Vennes and Metro Gem

107. PCI paid Mr. Vennes and his entity Metro Gem, Inc. ("***Metro Gem***") approximately $203 million in fees, commissions, and profits to secure investors, including the Funds. Metro Gem also borrowed millions of dollars from investors to loan to PCI, typically paying the investors 18% interest while charging PCI 30%.

108. Mr. Vennes and Metro Gem paid tens of millions of dollars in: (i) interest to their lenders, (ii) contributions to political figures, and (iii) donations to charities.

109. The Trustee and the Petters Trustee each sued Mr. Vennes.[123]

110. Given that there was no fiduciary appointed for Mr. Vennes or Metro Gem to clawback their historical transfers, MB developed an approach whereby the Trustee (on behalf of the Palm Beach Funds), as Mr. Vennes' creditor, would bring an 11 U.S.C. § 541 action under the state fraudulent transfer laws to avoid and recover these transfers.

111. Similarly, the Petters Trustee sought to avoid the transfers from PCI to Metro Gem and expressed an intent to pursue § 550 claims against the same transferees.

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[122] ECF No. 3771.
[123] Adv. Case No. 10-04352 (Bankr. D. Minn.); Adv. Case No. 11-03041 (Bankr. S.D. Fla).

112. The Trustee worked with the Petters Trustee to pursue and share recoveries.[124] The two trustees entered into an agreement providing for a joint mediation process and a division of recoveries. This led to a consensual resolution of over 50 claims.[125]

113. In 2012, certain charities successfully lobbied the Minnesota state legislature to amend MUFTA to provide a retroactive exemption for charities from avoidance liability.[126] The purpose was to stop the trustees' litigation. The amendment succeeded, insulating tens of millions of dollars in transfers and changing the trustees' focus to lenders to Metro Gem that received cash-on-cash profits.

114. In 2015, the Trustee and the Petters Trustee settled with Mr. Vennes and Metro Gem. Mr. Vennes and Metro Gem consented to the entry of judgments. Moreover, the parties agreed that Mr. Vennes would pursue tax refunds (seeking in excess of $15 million) with the cooperation of both Trustees and turnover to the Trustees all recoveries other than $750,000.[127]

115. Since then, the Trustee and the Petters Trustee have worked to recover the tax refund. In 2020, the U.S. Tax Court conducted a trial and the matter remains under advisement.[128] If successful, the Trustee would receive – after the first $750,000 – 40% of the remaining refund and the Petters Trustee would receive 60%. And per allowance of the PBF PCI Claim (discussed below), the Trustee also is entitled to a 1/3 interest in the Petters Trustee's recovery.

116. Excluding the potential tax refund recovery, total litigation recoveries to the Trustee are approximately $2,943,864.58. In addition, the PCI estate recovered approximately $6.8 million, for which the Trustee has a 1/3 interest through the PBF PCI Claim.

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[124] ECF No. 1282.
[125] *See e.g.*, Main Case ECF Nos. 1282 & 1350.
[126] https://www.mprnews.org/story/2012/04/03/charities-tom-petters-fraud-protection
[127] Main Case ECF Nos. 2650 & 2679.
[128] *Vennes v. Commissioner of Internal Revenue*, Docket No. 23860-17 (U.S. Tax Court).

117. MB was paid reduced hourly fees of $3,378,187.21 and contingency fees of $284,873.28.

i. Other Recoveries

118. The Trustee and MB resolved pre-suit potential claims against several parties with which the Debtors had little if any interaction. The Trustee reached settlements for $100,000 from Costco Wholesale Corporation in May 2016,[129] $775,000 from the Sabes family in October 2016,[130] and $437,500 from Fredrikson & Byron, P.A. in August 2012.[131] Fredrikson & Byron, P.A. was PCI's primary pre-petition counsel.

119. MB was paid reduced hourly fees of $26,032.14 in connection with the claim against Fredrikson & Byron, P.A. Reduced hourly fees related to Costco Wholesale Corporation and the Sabes family are contained with the general litigation categories. MB was paid contingency fees of $131,250.

XI. The Petters Bankruptcy Cases

A. Initial Overview and Outlook

120. Before the Trustee's appointment, the Palm Beach Funds viewed the PBF PCI Claim as having *de minimis* value. Berger Singerman LLP, the Palm Beach Funds' pre-petition counsel since March 2009,[132] informed this Court on December 2, 2009:

> The [D]ebtors have filed proofs of claim in [the Petters Bankruptcy C]ases, but we don't expect that the recovery, ***if any,*** will be more than pennies on the dollar.[133]

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[129] ECF No. 2913.
[130] ECF No. 3057.
[131] ECF No. 1351.
[132] ECF No. 81 ¶24.
[133] Dec. 2, 2009 Hearing Tr., pg. 8 (emphasis added); *see also* ECF No. 34, pg. 6 (Office of the U.S. Trustee: "*Upon review of Mr. Welt's Declaration and belief, the only assets of these estates appear to be the prosecution of claims against third parties. As indicated by [Berger Singerman]*

121. The outlook for recoveries in the Petters Bankruptcy Cases was understandably bleak. There was creditor infighting. The Petters Trustee considered the Palm Beach Funds to be a Chapter 5 avoidance target based on their alleged lack of "good faith." And the PBF PCI Claim was at risk of disallowance per 11 U.S.C. § 502(d).[134]

122. The prospect of the Petters Trustee's recoveries was uncertain. The Petters Trustee faced significant challenges and the litigation advanced slowly and was expensive to pursue.

123. The Petters Trustee's tort recoveries faced equitable defenses, especially because PCI and PGW pled guilty to federal crimes related to perpetration of a Ponzi scheme as part of a broad multi-party coordination agreement reached with the U.S.A. pursuant to which the U.S.A. agreed not to forfeit certain assets and avoidance claims held by the Petters Trustee.[135]

124. The two-year § 546 period expired on October 10, 2010. That day, the Petters Trustee filed over 100 adversary proceedings.

125. On April 6, 2011, the Petters Trustee filed a motion for substantive consolidation for eight of the nine Petters entities that were jointly administered in bankruptcy.[136] The Minnesota Bankruptcy Court conducted a three-day evidentiary hearing on December 12-14, 2011. Consolidation would significantly impact the avoidance actions, which were the primary litigation

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at the hearing on December 2, 2009, the Debtors have claims in the Petters entities bankruptcy cases but expect to receive a very small recovery if any.") (emphasis added).

[134] *See e.g.*, March 1, 2018 deposition of James Lodoen (lead counsel to the Petters Trustee) at pg. 28 "*[O]ver the course of time with meetings with Barry Mukamal and Mike Budwick and others from his firm, we had discussions about the Palm Beach claim and whether or not that claim should be disallowed …".*

[135] *See e.g.* ECF No. 407 in the Petters Bankruptcy Cases.

[136] ECF No. 1099 in the Petters Bankruptcy Case.

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claims. The Minnesota Bankruptcy Court granted the motion for substantive consolidation in a 107-page order issued nearly two years post-trial, on November 13, 2013.[137]

126. In the meantime, virtually all defendants moved to dismiss (or joined in motions filed by others). The motions were resolved largely in favor of the Petters Trustee in a trio of consolidated decisions issued on June 19, 2013, July 12, 2013, and September 30, 2013.[138]

127. Given that rulings on substantive consolidation and the motions to dismiss were not issued until five years from the Petters Bankruptcy Cases' petition dates, few settlements occurred. Generally, defendants were content to wait.

128. In early 2015, the Petters Trustee faced a huge unexpected challenge when the Minnesota supreme court eliminated the "Ponzi presumption" under MUFTA.[139] Since most of the avoidance actions involved transfers more than two years before the Petition Date (thus invoking § 544 and Minnesota state law), this decision complicated matters by sharply increasing the litigable factual issues the Petters Trustee would face.

B. Securing a Seat on the Petters Committee

129. Shortly after his appointment, the Trustee, MB, Mr. Varga and Mr. Estrada travelled to Minneapolis to meet with the Petters Trustee, the Office of the U.S. Attorney, and the Office of the U.S. Trustee. The Trustee wanted to (i) further understand the Petters Ponzi Scheme; (ii) determine the Petters Trustee's vision of the Petters Bankruptcy Cases as well as his intentions as to the PBF PCI Claim; (iii) cooperate with federal law enforcement; and (iv) request the Office of the U.S. Trustee (Minnesota) to add the Trustee to the three member Petters Committee.

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[137] ECF No. 2098 in the Petters Bankruptcy Case.
[138] ECF Nos. 1951, 2005 and 2044 in the Petters Bankruptcy Case.
[139] *Finn v. All. Bank*, 860 N.W.2d 638, 646–47 (Minn. 2015) ("***MUFTA***" refers to the Minnesota version of the Uniform Fraudulent Transfer Act).

130. The two members of the Petters Committee other than the Lancelot Trustee were profiteers, rendering the litigation targets unlikely to have their claims allowed. Nevertheless, the Office of the U.S. Trustee would not add the Trustee as a fourth member, citing concern for deadlock. Undeterred, the Trustee engaged directly with the Petters Committee which agreed to add the Trustee as an *ex-officio* member effective September 2, 2010.[140] While the Trustee could not vote, he could attend Committee meetings, be privy to information shared by the Petters Trustee, and contribute substantively to case management. Gaining access to information and the ability to steer case policy was a critical first step.

131. Ten months later, the Trustee's *ex-officio* role converted to full membership with voting powers. On July 25, 2011, the Office of the U.S. Trustee replaced James Fry (the manager of the Arrowhead hedge funds, a substantial profiteer) with the Trustee.[141] Mr. Fry was later convicted of securities fraud for lying to his funds' investors and sentenced to seventeen years.[142]

C. <u>The Road to Allowance of the PBF PCI Claim</u>

132. Over 90% of the losses in the Petters Bankruptcy Cases were concentrated among six groups of entities (Palm Beach Funds, Lancelot Funds, Richie Capital, Greenpond as successor

[140] PCI Bankruptcy Case ECF No. 448, pg. 2.
[141] PCI Bankruptcy Case ECF No. 1291.
[142] Case No. 11-00141 (D. Minn.); PCI Bankruptcy Case ECF No. 3131, pg. 35.

to Acorn,[143] Ark Capital, and Interlachen). The Funds hold the second-largest claim, constituting approximately 1/3 of the claims body on a cash-on-cash basis.[144]

133. Faced with broad opposition to the PBF PCI Claim, MB internally referred to the goal of achieving full allowance of the PBF PCI Claim as the "***Prime Directive***." The Trustee and MB would defend the claim at no reduction and make this known to the other major parties.

134. Given the tight concentration of claims, any creditor could meaningfully increase its distribution percentage by successfully challenging the claim of another.[145]

135. On June 1, 2009, Ritchie Capital objected to the PBF PCI Claim.[146] On May 7, 2010, Acorn objected to the PBF PCI Claim.[147] On October 10, 2010, the Petters Trustee objected to the PBF PCI Claim.[148] The Petters Trustee also filed proofs of claim in these Bankruptcy Cases based on the Funds' Chapter 5 clawback exposure to the Petters estates.[149] And throughout,

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[143] "***Acorn***" refers to Asset Based Resource Group, LLC, as successor to Acorn Capital Group, LLC. In December 2011, Greenpond South LLC, an affiliate of Stonehill, bought Acorn's claim, which had been allowed by final order in the amount of $141 million. One media report identifies the price as between $4-5 million or roughly 3%. https://www.startribune.com/petters-trustee-alleges-bogus-multi-million-dollar-claim/482332211/ Stonehill may confirm its purchase as indicative of the value Stonehill and the marketplace assigned in 2011 to *allowed* claims in the Petters Bankruptcy Case. A contested claim, such as the PBF PCI Claim, would be worth less.

[144] $651 million total cash-on-cash losses by the Palm Beach Funds of a total $1.9 billion in cash-on-cash losses.

[145] *See e.g., generally, In re Petters Co., Inc.*, 455 B.R. 166 (B.A.P. 8th Cir. 2011) (affirming Bankruptcy Court's rejection of creditor-Interlachen objection to Rule 9019 approval of settlement between the Petters Trustee and Acorn, through which, among other things, Acorn received a $141 million allowed claim); April 7, 2015 Hearing Tr. in Petters Bankruptcy Cases.

[146] ECF No. 219.

[147] ECF No. 345.

[148] Petters Bankruptcy Case ECF No. 636.

[149] *See* POC 23 in Case No. 09-36396 and POC 24 in Case No. 09-36379.

Interlachen stated it would seek disallowance or subordination of the PBF PCI Claim and requested the Petters Trustee to do so as the estate representative.[150]

136. The Petters Trustee's lead counsel has confirmed that dating back to 2010, the Petters Trustee intended to "have the [PBF PCI Claim] potentially disallowed if those transfers [to the Palm Beach Funds] were not recovered."[151]

137. The Petters Trustee did not focus merely on the Funds' due diligence and the criminal convictions of Messrs. Prevost and Harrold, but also the timing of a large reduction in their cash-on-cash exposure during the eleven months leading to the Raid. In late 2007, the Palm Beach Funds' cash-on-cash loss "peaked" when payments from PCI to the Funds slowed.[152] By February 2008, many PCI notes were on the verge of default. The Funds engaged in "note swap" transactions to avoid notes from defaulting. Groups of mature notes owed by PCI to the Funds to finance specific deals were exchanged for newly issued notes collateralized by different merchandise. Petters claimed that while a big box retailer was late paying on the earlier deal, it would pay on the later deal which was secured by fresher merchandise. Roughly $1.067 billion in notes were swapped including $176 million in "double-swapped" notes weeks before the Raid. The double-swapped notes were notes swapped in early 2008 that were swapped again 6 months later.[153] The double-swapped notes exacerbated the challenges presented by the note-swaps.

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[150] This is a question of "standing" to object. *See generally In re Trusted Net Media Holdings, LLC*, 334 B.R. 470 (Bankr. N.D. Ga. 2005) (surveying case law considering whether a creditor has standing to challenge another creditor's proofs of claim).

[151] March 1, 2018 deposition of James Lodoen pg. 20; *see also* pg. 28.

[152] *U.S.A. v. Prevost*, Case No. 11-141 (D. Minn.) April 21, 2011 Plea Agreement, pg. 6.

[153] For a detailed explanation of the swaps and double-swaps, see the expert report of Harvey R. Kelly, CPA of AlixPartners, LLP, an expert retained by GE Capital Corporation, attached as Exhibit 1 to ECF No. 604 in Adversary Case No. 12-01979.

138. PBF I's cash-on-cash loss exposure peaked on December 19, 2007 at $120,891,466. PBF II's exposure peaked on November 30, 2007 at $696,696,534. This combined loss of over $817 million decreased by over $166 million to $651 million by PCI's petition date. The Petters Trustee asserted that during the note-swaps, the Funds reduced their exposure at the expense of other creditors, particularly later victims (such as Interlachen). The Petters Trustee asserted the pay-down was funded by transfers not received in good faith, giving rise to a § 502(d) objection to disallow all of the PBF PCI Claim. The guilty pleas of Messrs. Prevost, Harrold and Vennes, along with the surrounding facts and circumstances (such as the note-swaps), were asserted as a basis to challenge the Palm Beach Funds' § 548(c) good faith defense.

139. In the summer of 2015, Plan negotiations commenced including negotiations to liquidate the major claims. The Petters Trustee met with each of the other major creditors and proposed to the Trustee the distribution scheme set forth in **Exhibit 2** ("***Petters Trustee Proposal***"). The Petters Trustee Proposal contained three iterations. The Palm Beach Funds would not participate in either the first $150, $160 or $175 million in distributions from the Petters Bankruptcy Case, resulting in a reduction in distributions to the Funds of anywhere from approximately $50 to $58 million as 1/3 of the creditor body.

140. For years, the Trustee and MB had prepared for these eventual negotiations. The Trustee and MB developed supporting arguments while also preparing to litigate if necessary.

141. From 2010 through 2015, MB investigated the facts surrounding all major creditors, interviewed witnesses, obtained documents, and monitored litigation across many dockets to compare the due diligence of other lenders to that of the Funds. MB developed evidence to demonstrate that the other lenders were not legally or equitably entitled to superior treatment. MB compared the 2008 conduct of the managers of certain of the other major creditor hedge funds

to that of Messrs. Prevost and Harrold. Thus, given that the victims were similarly situated, equity required that they be treated equally for distribution purposes.[154] Moreover, to the extent that the Petters Trustee was focused on Messrs. Prevost and Harrold, they would not participate in any distributions to the Trusts.

142. MB developed legal and factual defenses to the Petters Trustee's alleged avoidance claims and took the position that it could litigate these issues in this Court, rather than in Minneapolis, by objecting to the proofs of claim that the Petters Trustee filed in the PBF Cases.

143. MB developed facts and law that PCI defrauded the Palm Beach Funds and therefore the Palm Beach Funds indeed held fraud claims and were not complicit. Similarly, MB prepared to address the § 502(d) argument by developing facts to support that: (i) the Funds received the transfers in good faith; and (ii) the "good faith" standard should consider the comparative due diligence of other creditors.[155]

144. MB developed an equitable argument that the bulk of the Petters Trustee's recoveries would come from the clawback of fictitious profits. Much of those profits were sourced from the monies advanced and lost by the Palm Beach Funds. Thus, it would be inequitable for the Palm Beach Funds' losses to give rise to the primary avenue of recovery and yet for the Funds to be deprived of the right to participate in those recoveries.

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[154] *See e.g., generally, In re JWJ Contracting Co., Inc.*, 371 F.3d 1079, 1081 (9th Cir. 2004) (noting "the prime bankruptcy policy of equal distribution among similarly situated creditors.").

[155] As examples: (1) the Lancelot Fund's lead manager was criminally convicted (*U.S.A. v. Bell*, Case No. 08-299 (D. Minn.)); (2) The SEC charged Acorn's lead manager and was awarded a judgment (*S.E.C. v. Quan et al.*, Case No. 11-723 (D. Minn.)); (3) an Ark Discovery investor brought a civil action against Ark Discovery's lead managers and others, including for misrepresentations and securities violations. *See MVP Asset Management (USA) LLC v. Vestbirk, et al.*, Case No. 10-2483 (E.D. Cal.).

145. And to address directly the Petters Trustee's understandable concern about the $166 million paydown from November 2007 through September 2008, the Trustee and MB investigated the facts and underlying reasons. The reduction was not triggered by concerns about Petters' bona-fides; rather, it was caused by the "Great Recession." The global liquidity crisis prompted limited partners in the Palm Beach Funds to redeem their positions. As the Funds paid redemptions, they had less money to loan to Petters. Subject to their own liquidity, the Palm Beach Funds remained fully invested with Petters. Thus, the Funds' redeeming limited partners (not Messrs. Prevost and Harrold) triggered the reduction in the Funds' cash-on-cash exposure. KapilaMukamal prepared a supporting analysis. These facts also supported the Funds' lack of knowledge of the Petters Ponzi Scheme. This was presented to the Petters Trustee for his consideration.

146. While preparing to defend the PBF PCI Claims, MB also prepared to litigate other issues, such as challenges to claims of some of the major creditor claims.

147. At the same time, MB sought to convince the major parties that working cooperatively was superior to "creditor cannibalism." Rather than engage in a multi-party claims-contest, the Petters Trustee and the parties should join to maximize the recovery for all.

148. On August 24, 2015, the Trustee and MB attended a pre-mediation meeting at MB with the Lancelot Trustee and Greenpond. The parties negotiated what came to be known as the "***Miami Accord***," a framework that would set the basis for the agreements reached with the Petters Trustee at mediation and incorporated into the PCI Chapter 11 plan.

D. <u>The PCI Plan</u>

149. Stonehill has described to the Minnesota bankruptcy court the confirmation of the Petters Chapter 11 plan ("***PCI Plan***") as "a *remarkable achievement*."[156]

[156] ECF No. 3249 in the Petters Bankruptcy Cases, through Stonehill's affiliate, Greenpond.

150. The PCI Plan allowed the PBF PCI Claim in full, at 100% of the Funds' cash-on-cash losses (all creditor losses were to be measured on a cash-on-cash basis) with no reduction or subordination. Rather than 100% disallowance or the $50-58 million reduction in distributions per the Petters Trustee Proposal, the Funds' claims would not be reduced. And 100% allowance would help the Trustee fend off GE Capital's assertion (in the then pending adversary against GE Capital) that the Funds were not victims of the Petters Ponzi Scheme.

151. The Palm Beach Funds received certain payments during the 90-day period preceding the Petters Bankruptcy Cases petition date. The Funds would repay $5.1 million, or 80% of the 90-day payments, with that full amount added to the Funds' allowed claims per § 502(h). The Funds would participate in the distribution of the $5.1 million and the corresponding distribution from the disgorgement of all other creditors' 90-day payments, resulting in little net loss by virtue of the agreed-disgorgement, particularly since the Lancelot Funds would disgorge $10.495 million.

152. A more detailed discussion is set forth in the Liquidating Trustee's Motion for Authority with Respect to the Chapter 11 Plan of Liquidation for Petters Company Inc., *et al.*, where the Trustee requested authority (which was granted) from this Court to serve as a co-plan proponent (which he became) of the PCI Plan.[157]

153. The PCI Plan created a litigation trust ("***PCI Trust***") through which the Committee members (as the financial stakeholders) would control all litigation through a Liquidating Trust Committee ("***LTC***"). The Trustee would serve as one of the LTC's five members.

[157] ECF No. 2810.

154. Initially, Interlachen (a strong advocate of disallowance of the PBF PCI Claim) was not a party to the agreement reached at mediation. Eventually, agreement was reached with Interlachen and then Ritchie Capital and the Ark Discovery Trustee as well.

155. After years of "cold war" among the major creditors, consensus was reached with approximately 99% of $1.9 billion in claims by amount voting in favor of the plan.[158] This result was achieved over two years after Mr. Varga sold his claim because the risk was too great for him.

E. Reshaping of the PCI Litigation

156. The PCI Plan provided for Mr. Kelley to serve as Trustee of the PCI Trust. Mr. Kelley, a former federal prosecutor and highly regarded litigator, would serve as the estate representative, remaining actively involved as a witness in litigation while providing advice and counsel to the LTC on the high dollar, difficult issues that lay ahead.

157. In June 2016, Mr. Kelley and the LTC asked MB and Dorsey & Whitney LLP (Interlachen's counsel) to make recommendations for a fresh approach to the PCI Trust's litigation strategy. At the time there were 96 lawsuits pending seeking clawback of hundreds of millions in transfers or similar damages.[159] And Bankruptcy Judge Gregory F. Kishel, who had administered the PCI cases since inception, had retired on May 31, 2016. The PCI cases would be assigned to Bankruptcy Judge Kathleen H. Sandberg. The first step was to identify counsel for each specific role. Some of the firms had been previously engaged by the Petters Trustee.

158. Dorsey & Whitney LLP would be lead litigation counsel and handle the bulk of the litigation. The Dorsey team was led by J Jackson, Esq. a senior partner of the firm. John Marti, Esq., a former acting U.S. Attorney for the District of Minnesota and an original member of the

[158] ECF No. 3265 in the Petters Bankruptcy Cases.
[159] *See* Supplement to Trustee Kelley's Status Report, Petters Bankruptcy Cases ECF No. 3542.

U.S.A.'s criminal trial team against Mr. Petters in 2009 who had joined Dorsey in 2015, assumed a key role.

159. Other firms complemented Dorsey for specific matters. Quinn Emanual Urquhart & Sullivan LLP would handle claims against the Sabes family of Minneapolis (which received over $200 million in profits) and DZ Bank.

160. Kobre & Kim LLP would handle litigation in Minnesota and in offshore jurisdictions against the Epsilon Funds (which received over $300 million in profits) drawing upon its international collections expertise. The Trustee negotiated to convert the firm's method of compensation from hourly to contingency fee (with the firm advancing costs) through a litigation financing mechanism. Given the resources expended by the firm in the years since, this arrangement has proven beneficial to the PCI Trust.

161. Freeborn & Peters would handle certain litigation related to the Arrowhead Funds and other defendants for which other firms might be conflicted.

162. Barnes & Thornburg LLP and MB together would address substantial intercompany claims against the Polaroid bankruptcy estate.

163. Mr. Kelley had previously retained Boies Schiller Flexner LLP in a significant litigation against JPMorgan Chase & Co. and related parties. Given concerns as to the progress of that litigation, Quinn Emanuel, Dorsey & Whitney, and MB were asked to make contributions.[160]

[160] In August 2017, the PCI Trustee terminated Boies Schiller's representation. In June 2018, MB attended a mediation in Los Angeles and negotiated a resolution of that firm's asserted partial contingency fee. The Trustee was one of a number of parties to the settlement ultimately reached with JPMorgan and other defendants, which resulted in the defendants paying $30,725,000. *See* ECF Nos. 3444 and 3470 in this Case.

164. David Runck, Esq. of Fafinski Mark & Johnson, P.A. in Minneapolis had served as the Petters Committee's counsel since 2008. Given Mr. Runck's deep knowledge and historical contributions, he became the LTC's general counsel.

165. While MB contributed to certain specific litigation matters (particularly certain significant mediations), its primary role was to serve as Litigation Management and Oversight Counsel. Applying its knowledge of the Petters Ponzi Scheme and background in financial fraud cases, MB helped to manage all litigation and ensure consistency among the professionals.

166. MB suggested uniform procedures to advance the cases based in part on the success the Trustee had achieved advancing the many adversaries in these cases. Mandatory mediation was sought and ordered to occur. Uniform settlement parameters for profiteers were instituted to mirror the success the Trustee experienced in the PBF Cases. Trial tracks were proposed to motivate parties to settle and ensure that if a case did not settle it would conclude timely.[161]

167. MB suggested that the Petters LTC retain Robert Fishman, Esq. (now) of Cozen O'Conner P.C. as a fee examiner to independently review the professionals' fee requests. Mr. Fishman was retained and continues in that role.

168. In November 2016, the LTC retained Kevin O'Halloran to serve as Case Manager to manage substantially all day-to-day affairs and report to the LTC. Ultimately, he was added to the LTC as a voting member. Mr. O'Halloran is an experienced receiver, trustee, examiner and restructuring officer in cases throughout the country. He brought an exceptional level of diligence and professionalism and made enormous contributions towards advancing the remaining litigation and managing numerous settlement negotiations. His addition was a proverbial game-changer.

[161] ECF No. 3541 in the Petters Bankruptcy Cases.

169. And the LTC itself would be actively engaged making all material decisions on behalf of the PCI Trust, with the Trustee serving as one of its members. Mr. Mukamal attended significant mediations and was deeply involved in key decisions.

170. The team approach worked. The vast bulk of the litigation has concluded with hundreds of millions of dollars in distributions being made to the entire PCI creditor body. Along with the Trustee, MB was closely involved in a number of significant mediations and settlements, some confidential, typically with Mr. O'Halloran and other counsel. The PCI Trust paid MB's fees as Litigation Management and Oversight Counsel.

171. The benefit to this approach is reflected in the September 11, 2020 Eighth Circuit Court of Appeals' consolidated ruling[162] in an appeal of summary judgment rulings that had been entered by the district court in favor of the Petters Trustee against certain profiteers. Based on the Minnesota supreme court's decision in *Finn*, the Eighth Circuit reversed the entry of multiple judgments the Petters Trustee obtained disgorging millions of dollars in false profits. The Eighth Circuit held that PCI's contracts with lenders are not void as a matter of public policy and therefore lenders are deemed to have provided fair consideration in exchange for their profits. In effect, only those profiteers that failed to receive transfers in good faith would have clawback liability. This ruling highlights the enormous value in resolving the bulk of the 96 lawsuits pending in July 2016.

[162] *Kelley as Tr. for PCI Liquidating Tr. v. Boosalis*, 974 F.3d 884 (8th Cir. 2020). Moreover, on October 6, 2020, the Minnesota District Court entered an order granting summary judgment insulating a subsequent transferee of Arrowhead. The court found that the Petters Trustee could not avoid the initial transfer from one of the PCI consolidated debtors to a PCI investor (Arrowhead) pursuant to Section 546(e). *See Kelley v. Safe Harbor*, Case No 0:20-cv-00642-JRT at ECF No. 38. The Petters Trustee has appealed this decision.

F. The Results From the PBF PCI Claim

172. To date, the Trusts have received $113,309,598 in distributions from the PCI Trust on account of the PBF PCI Claim. This is roughly double the amount contemplated by the Petters Trustee Proposal. The amount of future distributions will depend on the outcome of limited remaining litigation.

173. The 17% distribution far surpasses the Debtors' counsel's statement in December 2009 that the recovery would be "*if any, [not] more than pennies on the dollar*."

174. The $113 million recovery far surpasses any reasonable expectations in 2010 when the Trustee, Mr. Varga and MB negotiated the MB Fee Arrangement.

175. The $113 million recovery far surpasses Mr. Varga's expectations in September 2013 when he sold the Varga PBF Claim for $16 million.[163]

176. MB was paid $4,586,167 to represent the Trusts in the Petters Bankruptcy Cases, roughly 4% of the recovery.

XII. Dispute with Mr. Varga

177. Mr. Varga was: (i) Trust Monitor and fiduciary for the Palm Beach Funds; (ii) Cayman Court-appointed liquidator of PB Offshore; and (iii) Cayman Court-appointed liquidator for one of the Lancelot Funds. As Trust Monitor in the PBF Cases, he was privy to the Trustee's confidential work product.[164]

178. Beginning in February 2010, the Trustee and MB worked closely with Mr. Varga as Trust Monitor and his estate-compensated professionals sharing with him confidential work-product.

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[163] Petters Bankruptcy Cases ECF No. 4028 ¶88.
[164] *See e.g.*, ECF Nos. 245, 444, 2119 & 2162.

179. In September 2013, when Mr. Varga sold the Varga PBF Claim to Stonehill, Mr. Varga terminated Reed Smith and contracted that Stonehill would direct him as Trust Monitor.

180. The Trustee was concerned with Mr. Varga contractually transferring his fiduciary obligations and powers to a third party without disclosure. The Trustee insisted that Mr. Varga: (i) modify his agreement with Stonehill to ensure his independence; and (ii) seek this Court's review and approval. Mr. Varga complied.[165]

181. In 2009, Mr. Varga had filed a claim in the Petters Bankruptcy Cases ("***Varga PCI Claim***"), as a backup in case the PBF PCI Claim was disallowed for any reason (such as based on § 502(d)). The Varga PCI Claim was included among assets Stonehill bought from Mr. Varga in September 2013. In 2016, Mr. Varga sought to enforce the Varga PCI Claim and receive over $90 million in distributions from the Petters Bankruptcy Cases.[166] This would have substantially diluted the Trusts' recoveries. The Trustee and MB asserted that Mr. Varga's actions violated his fiduciary duties, and among the Trusts' supporting evidence was Mr. Varga's 2013 agreement, approved by the Court, to exercise his fiduciary obligations independent of Stonehill.[167]

182. The Petters Trustee retained Foley & Lardner LLP to challenge this claim. The Petters Trustee, the LTC and Foley & Lardner walled off the Trustee and MB from many of their communications, including because the Petters Trustee's opposition to the Varga PCI Claim would potentially include challenging the due diligence Messrs. Prevost and Harrold performed on behalf of PB Offshore. Those factual challenges had potential to harm the Trustee's then pending

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[165] Main Case ECF Nos. 2118 & 2118-1 pgs. 25-26.
[166] *See generally*, ECF Nos. 3475 & 3553.
[167] *See generally, e.g.*, ECF No. 3475. Noteworthy is that, more recently, bankruptcy courts seem to address an increase in similar fact-situations. *See generally, e.g.*, *In re Farrell*, Adv. Case No. 16-1123 (Bankr. C.D. Cal. Oct. 22, 2019) [ECF No. 144]; *In re Neiman Marcus Group, Ltd LLC*, Case No. 20-32519 [ECF No. 1551] (Bankr. S.D. Tex. August 26, 2020) (complaint commencing adversary proceeding).

litigation against GE Capital. Where possible, the Trustee and MB worked cooperatively with the Petters Trustee, the LTC and Foley & Lardner to oppose Mr. Varga's claim on grounds other than the quality of PB Offshore's due diligence. In addition, the Trustee served Rule 2004 discovery upon Mr. Varga.[168]

183. Ultimately, the parties reached a global resolution favorable to the Trusts. The Varga PCI Claim would be allowed in the Petters Bankruptcy Cases for $45 million. But, Stonehill would provide the Trusts anti-dilution protection by reimbursing the Trusts for the dilution caused by distributions for this claim. To date, Stonehill has paid the Trusts $449,549 in anti-dilution payments. No other PCI creditor received anti-dilution protection. Further, Mr. Varga would resign as Trust Monitor in the PBF Cases.[169] This Court approved this resolution.[170] The dispute with Mr. Varga was unfortunate. However, the Trustee and MB took the necessary actions to protect the Trusts and prevent dilution of the Trusts' distributions from the Petters Bankruptcy Cases.

XIII. Certain Considerations Relevant to Determining the Additional Fee

184. MB recognizes and appreciates that it has been paid significant fees in these cases. However, MB respectfully suggests that a comparison of the results achieved to the reasonable expectations of stakeholders in 2010 reflects MB has earned its contractual right to an additional fee.

185. Where appropriate, courts may employ other calculation methods to "ensure that the fee produced by the chosen method is in the ballpark of an appropriate fee."[171] MB submits the following in furtherance of such an analysis.

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[168] ECF Nos. 3494 & 3498.
[169] ECF No. 3543.
[170] ECF No. 3551.
[171] *See In re Home Depot Inc.*, 931 F.3d 1065, 1091 (11th Cir. 2019) (citing cases).

A. Percentage of Fees to Recoveries

186. Through September 30, 2020, the Trustee has recovered $229,855,252. This is comprised of $113,309,598 in recoveries from the Petters Bankruptcy Cases, $115,835,871[172] in recoveries from the Trustee's litigation in the PBF Cases, and $709,783 in other receipts.[173]

187. From its retention in February 2010 through September 30, 2020, MB has been paid approximately $18.76 million in hourly fees and $19.5 million in contingency fees. Of the contingency fees, $14.2 million was paid in 2019 at the conclusion of the GE Capital litigation.

188. Through December 31, 2020, MB's total hourly, hybrid and contingency fees are approximately 16.7% of the gross recoveries. This includes the matter referenced at footnote 172 because identifying the percentage without that settlement would disclose the amount of the settlement. However, excluding that settlement that does not alter the percentage materially. Since 2010, MB has had 19 attorney timekeepers, and 23 non-attorney timekeepers, who have billed 55,353 hours to the Funds' estates. The blended rate is $339.

189. The Trustee filed over 150 adversary proceedings and pursued complex claims against a regional accounting firm, four law firms and three major financial institutions. To prosecute these claims, the Trustee was required to invest enormous non-attorney resources. These cases required consulting and testifying experts in various fields as well insolvency and damages, a computer forensic expert, a private investigator, jury consultants, and many mediators. Transcripts were ordered for over one hundred Rule 2004 examinations or depositions as well as numerous hearings in this Court and other courts. The Trusts paid millions of dollars to Mr. Varga

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[172] One litigation matter was handled by Reed Smith as special counsel with MB serving a limited support role at 75% of rates. The amount of that settlement is under seal.

[173] The other receipts are sourced from interest income, turnover of pre-petition Debtor professional retainers, recovery of accounts frozen through the Petters receivership, and a small distribution as a creditor in PB Offshore.

and his professionals for his role as Trust Monitor. Travel expenses were significant due to the need to travel throughout the country for depositions, meet witnesses in prisons, meet with the Petters Trustee in-person, meet with Mr. Varga and his team in-person, and appear in multiple courts in Minneapolis.

190. All fees incurred by (1) the Trustee; (2) his counsel including MB;[174] (3) the Trust Monitor; (4) the Trust Monitor's general, local counsel and Cayman counsel; (5) banking experts; (6) AML experts; (7) legal malpractice experts; (8) accounting and insolvency experts; (9) hedge fund due diligence experts; (10) computer forensic experts; (11) mediators;[175] and costs for (12) hearing and deposition transcripts; (13) photocopies; (14) travel and lodging; (15) data storage; (16) jury consultants; (17) graphics and demonstratives; (18) private investigators; and (19) Trustee surety bond premiums,[176] total $68.3 million. The ratio of all of those fees and expenses to recoveries for both Trusts is 29.8% (34% in PBF I and 28.9% in PBF II). If the Additional Fee is approved, the ratio for both Trusts would be 32%.

191. MB's hourly and contingent fees have been 16.66% of total recoveries.[177] If the Additional Fee is approved, the ratio would be 18.83%.

192. Given the Debtors began these cases with no available cash or physical assets, together with the risks and complexities, MB submits that this is an exceptional "return on investment."

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[174] Local counsel fees in Minneapolis were paid to Parker Rosen and Kluger Kaplan in the amount of $603,926.

[175] Mediator fees of $213,349 were incurred for Robert Fishman of Shaw Fishman; Phillips ADR Enterprises, P.C.; Mediation Solutions; Francis Carter of Katz Barron; Harley Riedel of Stichter Riedel; Gilbert Mediation; Ed Dobbs of Parker Hudson; and Judge (retired) Richard Solum.

[176] International Sureties, Ltd. was paid $449,063.

[177] Again, MB was not counsel in the matter identified in the Report Card as "Settlement Filed Under Seal." MB does not identify its percentage of fees to recoveries other than the settlement under seal since doing so might enable one to extrapolate the amount of that settlement.

B. Financial Risks

193. When the Trustee retained MB, there was no available cash and MB had no assurance of being paid. MB was first paid fees upon confirmation of the PBF Plan when the Kaufman settlement was approved. Given the need to retain specialized experts to support litigation efforts along with the costs of compensating the Trust Monitor and his legal and financial professionals, MB assumed risk at the outset, highlighted by Mr. Varga's decision to sell in September 2013. The Additional Fee component of the alternative fee arrangement was crafted and tailored to the particulars of these cases in the professional business judgment of both the Trustee and Mr. Varga based in part on their assessment of the risks that existed at the time.

C. Mr. Varga September 2013 Decision that the Financial Risks Were Untenable

194. Mr. Varga's marketing and sale of the Varga PBF Claim, and the $16 million sale[178] price as the "highest and best bid," evidences how Mr. Varga and sophisticated financial players including Stonehill[179] valued the Trusts' prospects for recoveries by September 2013.[180]

195. While Mr. Varga focused on eliminating his firm's "untenable" financial risk, the Trustee and MB continued zealous pursuit of recoveries. Through three interim distributions, the Trustee has distributed to Stonehill $93,168,000. The impending fourth distribution will bring this total to $111,850,200. A fifth distribution is expected when the Petters Bankruptcy Cases close.

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[178] Mr. Varga's 14th Report states he received $9.8 million, rather than $16 million.

[179] Stonehill certainly may share its methodology and financial model supporting its $16 million proposal and Mr. Varga may share the other proposals he received along with any expressions of lack of interest.

[180] The price of an item arrived at through arms-length negotiations evidences that the price was the "value" of the item sold. *See U.S. v. Lehning*, 742 F.2d 1113, 1115 (7th Cir. 1984); *A & B Steel Shearing & Processing, Inc. v. U.S.*, 934 F.Supp. 254, 257–58 (E.D. Mich. 1996) ("[O]ne acceptable measure of the value ... is a price agreed upon between parties engaged in a bona-fide, arms-length negotiation.").

196. Given Mr. Varga's extensive knowledge, his marketing efforts, the professional advice he received from his team of financial and legal professionals, and the availability of other alternatives, Mr. Varga's decision to sell the Varga PBF Claim for $16 million and Stonehill's $95+ million profit evidences the extraordinary "results achieved."

D. <u>The Results in the Petters Bankruptcy Cases</u>

197. MB was paid $4,578,132 in fees for its work related to PCI, roughly 4% of the $113 million in recoveries it achieved with the Trustee.

198. Under the Petters Trustee Proposal the Trusts would have received $50-58 million less from the Petters Bankruptcy Cases. The Additional Fee sought is 9-10% of this amount.

199. Had MB been retained on a 75% of fees/10% of recoveries basis to pursue the PBF PCI Claim, as it was akin to a litigation matter, MB would have been paid $3.4 million in fees plus $11.3 million in contingency fees for a total of $14.7 million. This is approximately $10.1 million more than it has been paid, or twice the Additional Fee sought.

E. <u>The Debtors' Proposed Retention of Litigation Counsel</u>

200. The Debtors' CRO, Kenneth A. Welt,[181] has served as a panel Chapter 7 trustee in this district for decades administering over 150,000 cases. In his professional judgment and with the advice of sophisticated bankruptcy counsel, he determined that the risks and circumstances at the time warranted a fee to litigation counsel equal to 40% of all recoveries from all sources. In addition, he would pay separate hourly fees to his bankruptcy counsel. The Debtors' steering committees representing the majority of the limited partners supported this proposed compensation.

[181] http://www.kawpa.com/resume.html.

201. Had proposed counsel replicated the $229 million in recoveries, the litigation counsel fee would have exceeded $91 million, exclusive of hourly fees to Berger Singerman. The fees paid to MB included payment for administrative work apart from litigation, such as confirming a Chapter 11 PBF Plan, adjudicating claims, resolving application of § 510(b), preparing fee applications for most estate professionals, keeping stakeholders informed, and general case administration.

202. Had MB been retained on the methodology of 40% of recoveries that Mr. Welt proposed to provide litigation counsel, the fees related to the Petters Bankruptcy Cases alone would have been paid $45.2 million, $40.6 million more than the fees that have been paid and far more than the Additional Fee sought.

F. <u>Consensual Resolution of Claims</u>

203. MB efficiently liquidated claims and resolved the priority of distributions.

204. Claims of well over one hundred stakeholders aggregating in the hundreds of millions of dollars were amicably and inexpensively resolved relatively quickly and quietly.

205. The Trustee and MB maximized distributions to all classes of creditors. The PBF Plan identified classes of creditors to receive distributions but left open the application of 11 U.S.C. § 510(b), which could have eliminated recoveries by: (i) all PBF II Trust stakeholder claims other than PB Offshore; and (ii) many of the PBF I stakeholder claims.[182] Accordingly, similarly situated parties faced being treated very differently and (arguably) unfairly.

206. The Trustee and MB consensually resolved the application of § 510(b), an issue that plagued the PBF II steering committee and Mr. Varga. Recognizing that all of the Funds' stakeholders were crime-victims of the Petters Ponzi Scheme, the Trustee and MB managed a

[182] *See generally, e.g.*, ECF No. 3139.

process where all stakeholder classes would receive some measure of distribution. The Trustee and MB: (i) obtained this Court's approval for a mediation open to all stakeholders; (ii) achieved a mediated and consensual resolution of distribution priorities; and (iii) presented the agreement to this Court for its consideration and approval.[183]

207. Moreover, the Trustee and MB ensured all parties in interest remained informed throughout via a website and regular status letters along with status telephone calls with certain of the more significant stakeholders. Since the Trustee's appointment, the lengthy docket reflects no disputes with creditors as to the manner of administration of the Trusts, a meaningful accomplishment over eleven years given the number of stakeholders.

G. <u>Rates of Other Professionals</u>

208. While not a perfect comparison, as a data point, MB notes the hourly rates of other professionals in the PBF Cases and other Petters-related cases.

209. In 2013, Mr. Varga charged the Trusts at an hourly rate of $750.[184] While Mr. Varga is an accountant and not an attorney, his rate was over 25% higher than that of the highest rate of any MB professional at the same time.

210. In 2013, Mr. Varga's lead counsel, Mr. Estrada, charged the Trusts $815 hourly, over 35% higher than that of the highest rate of any MB professional at the same time.[185]

211. In 2015, Greenpond (Stonehill's affiliate) sought fees under § 503(b) of the Code before the Minnesota Bankruptcy Court in the Petters Bankruptcy Cases, where lead counsel Benjamin Finestone, Esq. billed Greenpond $840 hourly, approximately 35% higher than the

[183] ECF Nos. 3135, 3137, 3139, 3178 & 3179
[184] *See* ECF No. 1932.
[185] Main Case ECF No. 2077, pg. 20.

highest rate of any MB professional at the same time.[186] Greenpond stated in that application that Mr. Finestone's rates "are comparable to those employed by other similar professional firms in complex bankruptcy matters."

212. MB recognizes the unique talents of Messrs. Estrada and Finestone and does not intend to compare one lawyer to another. However, these rates offer a potential "cross-check" as envisioned by the Eleventh Circuit (described in more detail below), and evidence that a 15% or 20% increase on MB's total fees is well within an objectively reasonable range for an appropriate Additional Fee.[187]

H. Other Challenges Met Due to the Nature of These Cases

213. Michael Budwick has spent the majority of his career working on financial-fraud matters, often representing fiduciaries.[188] Mr. Budwick and Solomon Genet led the MB team from the inception of the representation of the Trustee. The continuity of the team's leadership throughout these cases promoted efficiencies and maximized the results. However, it is important to stress that a number of MB attorneys served important roles in significant aspects of these cases.[189]

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[186] Petters Bankruptcy Case ECF No. 3249, pg. 18.

[187] *Home Depot*, 2019 WL 3330867, *19; *cf. Rose Pass Mines, Inc. v. Howard*, 615 F.2d 1088, 1092 (5th Cir. 1980) & *Weyerhaeuser Co. v. Yellow Poplar Lumber Co., Inc.*, 2017 WL 2799316, *8 (W.D. Va. June 28, 2017) (citing cases).

[188] A summary of Mr. Budwick's and Mr. Genet's professional background is contained in each of MB's fee applications. *See e.g.*, ECF No. 3741, pgs. 11-13.

[189] While MB is fortunate to have experienced significant longevity among its attorneys and staff, it is inevitable that over an eleven year period attorneys will move on to other professional opportunities. A number of former MB attorneys contributed at over varying times to these cases, including four who no longer practice law: (now) United States Bankruptcy Judge Peter D. Russin, (now) Miami-Dade County Circuit Judge Zachary James, Jessica Wasserstrom, Zaharah Markowe, Jonathan Feldman, Joshua Marcus, and Joseph Wasserkrug. All contributed to the team effort.

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214. "Witness interviews, conducted in private, are routine components of nearly every attorney's case preparation."[190] Here many key witnesses were incarcerated throughout the country. Prisons place material limitations on communicating with inmates,[191] creating logistical difficulties,[192] delays and expense.[193] MB visited with witnesses in various prison facilities, each with differing logistical requirements, including in Long Beach, CA; Leavenworth, KS; Butner, NC; Orlando, FL; Miami, FL; Englewood, CO; and multiple cities in Minnesota.[194]

215. The need to (i) meet inmates and other witnesses, (ii) attend scores of Rule 2004 examinations and depositions; (iii) attend hearings in Minneapolis, and (iv) attend mediations in multiple cities resulted in an inordinate amount of travel, particularly from the fall of 2010 through the spring of 2016. The extraordinary travel presented professional and personal challenges.

XIV. Law and Analysis

A. Standard

216. MB's contractual right[195] to seek an Additional Fee based on the "*outcome and results achieved in connection with the Debtors' cases, including the results of and amounts of*

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[190] *In re Am. Med. Sys., Inc.*, 946 F. Supp. 2d 512, 514 (S.D. W.Va. 2013).
[191] *See e.g.*, http://www.prisonpro.com/content/englewood-federal-correctional-institution.
[192] Frequently, meeting times were limited or cut short by lockdowns or prison counts (even after MB had flown across the country to visit the witness). Communicating by U.S. Post Office with added internal prison security often presented delays, and the prison electronic communication system presented limitations. After Mr. Vennes' conviction, MB met with him in an Orlando federal correctional facility. Because the warden prohibited paper and writing instruments, MB sought to memorize the precise details of the discussion and prepare notes immediately afterwards in the facility parking lot.
[193] *See e.g.*, ECF Nos. 2024 & 2025.
[194] MB also visited a witness under house-arrest outside Minneapolis.
[195] This is a key distinction, *i.e.*, between (1) "enhancement" under applicable law; and (2) award of an additional fee as part of an agreed-fee package from the outset and approved by the Court after notice to all parties. *Cf. Matter of First Am. Health Care of Georgia, Inc.*, 212 B.R. 408, 416 (Bankr. S.D. Ga. 1997) (identifying consent by the party paying the fee as a factor where that consent is "evidenced by a contractual agreement for enhancement") (citing *In re Healthmaster*

distributions from the Petters Bankruptcy Cases," was first approved by the Court in August 2010 and then ratified in October 2010 through the PBF Plan (which received near universal approval). This contractual right is distinct from a common law fee enhancement request.[196]

217. The largest creditor was directly involved in negotiating a comprehensive method of compensation, with one component to be assessed years later near the end of the case when the results achieved would become known. Over ten years later, those results are now known.

218. While MB submits that it satisfies the standard for a fee enhancement, MB seeks an Additional Fee based on contractual agreement, this Court's Orders, the PBF Plan, and 11 U.S.C. § 330. To the extent that the Court determines that the enhancement standard should apply, MB requests leave and reserves the right to supplement this Motion as appropriate.

219. MB notes:

> [F]or decades, the law in this circuit has been that the court, either trial or appellate, is itself an expert on the question and may consider its own knowledge and experience concerning reasonable and proper fees and may form an independent judgment either with or without the aid of witnesses as to value.[197]

220. This Court has wide and considerable discretion on whether to award the requested relief, and in determining whether an evidentiary hearing is necessary.[198] Based on the record, MB

Home Health Care, Inc., Case No. 95-10548 (Bankr. S.D. Ga., July 25, 1996) [ECF Nos. 327 and 328] (unavailable on PACER)).

[196] *See In re Janata*, 395 B.R. 496, 499 (Bankr. S.D. Fla. 2008) (discussing standard for fee enhancement); *see also In re Gurley*, 379 B.R. 194, 201-02 (Bankr. M.D. Fla. 2007); *In re Levy*, 2006 WL 4102217, *2 (Bankr. M.D. Fla. Nov. 13, 2006).

[197] *Taylor Newman Cabinetry, Inc. v. Classic Soft Trim, Inc.*, 436 F. App'x 888, 894 (11th Cir. 2011) (notations omitted); *see also St. Louis Condo. Ass'n, Inc. v. Rockhill Ins. Co.*, 2019 WL 7905013, *5 (S.D. Fla. Oct. 10, 2019) ("[T]he Court is presumed to be an expert in reviewing the number of hours expended on litigation for the purpose of attorney's fees.").

[198] *In re Asarco LLC*, 2013 WL 6190455, *4 (S.D. Tex. Nov. 26, 2013) (fee enhancement award is reviewed for abuse of discretion) (citing cases); *Deutsche Bank Nat'l Tr. Co. v. Jackson*, 2016 WL 5390594, *6 (S.D. Fla. Sept. 27, 2016) ("This Court reviews a bankruptcy court's decision not to conduct an evidentiary hearing for abuse of discretion."); *see also Norman v. Hous. Auth. of City of Montgomery*, 836 F.2d 1292, 1304 (11th Cir. 1988) & *In Re: First Colonial Corp.*, 544

respectfully submits that an Additional Fee of $5 million is fair and reasonable under all the circumstances.

B. 11 U.S.C. § 330 and the *Johnson* Factors, Generally

221. Through all of MB fee applications in these Cases, MB presented for the Court's consideration that MB has satisfied the *Johnson* factors and 11 U.S.C. § 330.[199] This Court approved each MB fee application, and as provided for in § 7.1.1 of the PBF Plan and the Orders themselves, the Court's Orders granting these applications are "final."

222. It is a testament to the quality of the administration of these cases by the Trustee and MB that no party has sought to object to any of MB's fee applications[200] or challenged that MB's professional services satisfied the *Johnson* factors and 11 U.S.C. § 330.[201] Although the Court has entered final approval of MB's fee application, each applicable final order provides for a reservation of MB's right to seek an Additional Fee.

C. Positions of Certain Parties

223. The Trustee, who is intimately familiar with MB's efforts, supports MB's request for the Additional Fee.

224. MB and the Trustee have communicated with Stonehill (the largest stakeholder of the PBF II Trust) and MIO[202] (the largest stakeholder of the PBF I Trust). Stonehill and MIO have advised that they do not consent to the requested relief.

F.2d 1291 (5th Cir. 1977) (where a fee request is sufficiently developed in the record, an evidentiary hearing can be unnecessary).

[199] *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir.1974) and its progeny.

[200] *See generally*, docket.

[201] *See, e.g., In re All Am. Semiconductor, Inc.*, 427 B.R. 559 (Bankr. S.D. Fla. 2010) (citing cases); *see also Capitol Hill Grp. v. Pillsbury, Winthrop*, 569 F.3d 485, 492 (D.C. Cir. 2009).

[202] MIO Partners, Inc. ("***MIO***"). *See* ECF Nos. 2746 as to the amount of the allowed claims of MIO and entities it manages.

225. MB understands that its requested relief would necessarily result in a reduced amount distributable to stakeholders.[203] However, as a Massachusetts bankruptcy court noted:

> While dilution of the dividend for creditors may, in some circumstances, inform a court's decision whether or not to grant a fee enhancement, the Court is mindful that in every non-surplus case, each dollar paid to a trustee or estate professional is one unavailable for distribution to creditors. This is not, in and of itself, a reason to deny appropriate compensation.[204]

XIV. Conclusion

226. At a May 30, 2019 hearing, this Court stated that "*[t]his has been an extremely well administered case by the trustee and the trustee's professionals, resulting in a very remarkable, in my view, recovery for creditors …*"[205]

227. In 2010, at the beginning of these cases, the Trustee, Mr. Varga and MB agreed on a comprehensive alternative fee arrangement. At the time, Mr. Varga described the estates to this Court as administratively insolvent and unable to pay professional fees and costs.[206] The intent was to shift risk onto MB as the estates' lead professional that would invest the most resources when the estates' only assets were difficult potential litigation claims, while also providing MB an incentive to be rewarded for its success. Mr. Varga, a professional fiduciary experienced in negotiating fee arrangements with attorneys in large, complex commercial insolvency proceedings, was represented by Reed Smith in the process.

228. The Additional Fee component would allow this Court – years later, with the benefit of hindsight – to take a fresh look at MB's performance throughout the life of these cases,

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[203] Over 80% (approximately $4.1 million) would be borne by Stonehill. The balance would be borne by over one hundred stakeholders in both Trusts.
[204] *In re New England Compounding Pharmacy, Inc*., 544 B.R. 724, 738 (Bankr. D. Mass. 2016).
[205] May 30, 2019 Hearing Tr., pg. 4 [ECF No. 3633]; *see also* May 21, 2020 Hearing Tr., pg. 7 [ECF No. 3722].
[206] *See* footnote 75.

review the results achieved, and exercise its discretion in accord with the governing standard and applicable law to determine whether MB has earned an Additional Fee based on actual results.

229. The alternative fee agreement was approved by the Court in August 2010 and then ratified by stakeholders and approved a second time by the Court in the confirmed Plan. Ten years post-confirmation, it remains the controlling fee agreement. Every MB fee application beginning in September 2010[207] references the right to seek an Additional Fee, restating the original agreement:

> Depending on the outcome and results achieved in connection with the Debtors' cases, including the results of and amounts of distributions from the Petters Bankruptcy Cases, [MB] shall be entitled to seek additional fees based on the results achieved.

230. While Mr. Varga sold his claim in September 2013, the Trustee and MB remained zealous and aggressive throughout. MB respectfully asserts that its performance and the outstanding results achieved by the Trustee warrant the award of an Additional Fee in the amount of $5 million.

231. The confirmed Plan provides for a Pro Rata Allocation Formula to apportion certain expenses and recoveries, 18% to PBF I and 82% to PBF II. However, the Trustee's claims in the Petters Bankruptcy Cases were allowed on a cash-on-cash basis yielding a ratio of 13.27% to PBF I and 86.73% to PBF II. Given that a meaningful part of the basis for MB's request for the Additional Fee is the "results achieved" in the Petters Bankruptcy Cases, MB suggests allocating the Additional Fee 13.27% to PBF I and 86.73% to PBF II.

[207] *See* ECF No. 307.

WHEREFORE, MB respectfully requests an Order: (1) granting this Motion, (2) approving payment to MB of the Additional Fee; and (3) for such other and further relief as this Court deems just and proper.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was served on January 29, 2021, via the Court's Notice of Electronic Filing upon registered Users listed on the attached Exhibit 3.

s/ Michael S. Budwick
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July 1, 2011

VIA EMAIL & U.S. MAIL

Michael S. Budwick
Meland Russin & Budwick, P.A.
3000 Wachovia Financial Center
200 South Biscayne Boulevard
Miami, FL 33131

RE: Proposed Complaint by Barry Mukamal, the Liquidating Trustee for the Palm Beach Finance Partners, L.P. and Palm Beach Finance II, L.P. Liquidating Trusts Against M&I Marshall & Ilsley Bank

Dear Mr. Budwick:

By letter dated May 12, 2011, you expressed the intent to commence a lawsuit on behalf of Barry Mukamal, the Liquidating Trustee for the Palm Beach Finance Partners, L.P. and Palm Beach Finance II, L.P. Liquidating Trusts, against my client, M&I Marshall & Ilsley Bank ("M&I"). On June 21, 2011, I received a copy of the draft Complaint that you intend to file on July 5 (notably, seven business days later). Having reviewed the draft Complaint, it is apparent that the legal and factual contentions set forth therein are unwarranted under existing law and completely lacking in evidentiary support. To be clear, it is M&I's position that you have fabricated, misconstrued and omitted evidence in an attempt to state a cause of action against M&I.

As such, this letter serves as notice that, should the Trustee proceed to file the Complaint and bring the claims set forth therein, M&I intends to serve you with a formal Motion for Rule 9011 Sanctions and proceed accordingly under that rule.

RULE 11 PROHIBITS NOT ONLY AFFIRMATIVE MISREPRESENTATIONS, BUT THE FAILURE TO ACKNOWLEDGE POTENTIALLY DISPOSITIVE FACTS.

As you are, of course, aware, Federal Rule of Bankruptcy Procedure 9011 is designed "to deter baseless filings." *In re Walker*, 532 F.3d 1304, 1309 (11th Cir. 2008). To this end, Rule 9011 makes the sanctions provisions found in Rule 11 of the Federal Rules of Civil Procedure applicable to pleadings filed in bankruptcy. *In re Concord Nopal Agency, Inc.*, 92 Br. 956, 957 (Bankr. S.D. Fla. 1988). The Eleventh Circuit instructs courts to look to case law that interprets Rule 11 when applying Rule 9011. *In re Kirk-Murphy Holding, Inc.*, 313 Br. 918, 921 (Bankr. N.D. Fla. 2004). Sanctions are warranted (1) "when a party files a pleading that has no reasonable factual basis" or (2) "when the party files a pleading that is based on a legal theory

EXHIBIT 1

that has no reasonable chance of success . . . ." *Jones v. International Riding Helmets, Ltd.*, 49 F.3d 692, 694 (11th Cir. 1995); FED. R. BANKR. P. 9011(b)(2)-(3) (2011).

It is abundantly clear, moreover, that a party may not escape the effect of potentially dispositive facts or defenses simply by omitting them from the complaint. *See, e.g., Blackwell v. Department of Offender Rehabilitation*, 807 F.2d 914, 915 (11th Cir. 1987) (*per curiam*) (plaintiff had an "affirmative obligation" to note potentially dispositive settlement agreement in his initial pleadings); *Cargile v. Viacom International, Inc.*, 282 F. Supp. 2d 1316, 1319 (N.D. Fla. 2003) (plaintiff's counsel violated Rule 11 by continuing to press plaintiff's misappropriation claims after being advised, among other things, of facts demonstrating that statute of limitations had run and that defendant had created the allegedly misappropriated cartoon character before plaintiff had).

YOU HAVE IGNORED, DISTORTED, AND EVEN MISREPRESENTED CRITICAL FACTS.

The draft Complaint is factually inaccurate and misleading. It omits essential facts of which you are well aware and which are fatal to the claims you threaten to allege. It is premised on factual assertions that you know to be contrary to the truth. And, it includes factual assertions for which there is no support in any M&I testimony or documents or, to the best of our knowledge, anywhere else. To the extent you have in your possession evidence from another source that you believe supports these allegations, we demand that you produce such evidence immediately.

Without any attempt to be exhaustive, we summarize some of the more egregious and important factual errors here.

You Have Completely Ignored The Fact That The Funds' Own Management Had Full Knowledge Of Petters' Scheme.

As you are well aware, the Palm Beach Funds were managed and controlled by David Harrold and Bruce Prevost, both of whom were indicted and pled guilty to federal criminal securities fraud charges associated with the Petters' scheme. As is abundantly clear from the indictments, the criminal complaints, and the guilty pleas, as well as a wealth of other facts and circumstances unknown to M&I at the time but which have come to light in the various criminal proceedings, Harrold and Prevost were fully aware of the nature of Petters' scheme. They knew from the very beginning that the payment flow described to their investors was not accurate, *i.e.*, Palm Beach never received a cent directly from any inventory purchase. Indeed, they almost certainly knew that the alleged purchases and sales of electronics were fictitious. Moreover, by late 2007, they knew that Petters was no longer satisfying notes in a timely fashion. In order to conceal PCI's delinquency, they orchestrated a series of fraudulent "note swaps" designed to create the illusion that the investment scheme continued to generate profits and, to further

perpetuate the fraud, continued to report in monthly communications to investors that the Funds were generating the same steady profits they had generated from their inception. They deliberately failed to disclose that the "profits" they reported were no longer calculated on the basis of cash received but, instead, treated replacement notes as the equivalent of cash. They knew, or decided to remain deliberately ignorant that the purported security for such new notes was illusory.

In short, the very persons that the Fund's investors selected to manage their funds and protect their investments were part and parcel of the Petters' scheme. The legal consequences of this fact are discussed below. But your failure to acknowledge it in your draft Complaint is, quite frankly, outrageous.

Your Assertion That M&I Had Knowledge Of The Fraud Is Completely Unsupportable.

The notion that M&I had any knowledge of the Petters' fraud, much less that it agreed to "facilitate, assist and aid" it, is completely without basis. Nor does the circumstantial evidence alleged in the draft Complaint suggest even constructive knowledge, much less actual. For example, the draft Complaint makes allegations regarding events that allegedly occurred in 2002 and 2003 that are unsupported by any testimony or documents produced by M&I or its employees. We cannot list here all the liberties you have taken with the evidence; the most egregious examples arise in the context of allegations surrounding the alleged meetings between M&I's Ed Jambor and Shari Rhode and Jon Sabes, one of Petters' investors, in February 2003. (*See* paragraphs 75 through 84.)

The allegation that M&I "stepped into" discussions between and among Petters and Sabes is false and misleading. Based on Jambor's and Rhode's alleged participation in a Sabes meeting, you suggest that, as of February 2003, M&I knew that money supposedly being sent by retailers to PCI was placed in the M&I account, and that PCI was holding these funds in trust for the benefit of investors. Next, you allege that before the February 2003 meeting, Coleman contacted Jambor, explained to him that Sabes was seeking a meeting with M&I regarding control over the M&I account, that Petters wanted to placate Sabes by allowing him to meet with M&I, and that Petters had absolutely no intention to enter any such arrangement proposed by Sabes. Then you boldly assert that Jambor agreed to participate in the façade.

Aside from the February 19, 2003 e-mail referred to in ¶ 7a (and which was marked as Exhibit 1 during the depositions of Mr. Jambor and Ms. Rhode), we are aware of no evidence that supports the allegations in any way. This email does nothing more than suggest that Sabes inquired as to whether M&I would consider a custodial relationship to receive wire payments. Jambor and Rhode testified that they had no recollection of any meeting or any e-mail exchange with Mr. Sabes. Neither the February 19, 2003 email, nor any document M&I has produced support the proposition that M&I had any independent knowledge that money being sent by

retailers to PCI was placed in the M&I account, or that PCI was holding these funds in trust for the benefit of its investors.

Most significantly, there is no testimonial or documentary support whatsoever for the proposition that Jambor agreed to participate in any façade to placate Sabes. Mr. Jambor and Ms. Rhode unequivocally denied this allegation and testified that they had no recollection of any communications with or related to Sabes. Accordingly, we demand that you immediately produce any evidence in your possession that you contend supports these allegations.

You Have Completely Distorted Ordinary, Unremarkable Contacts Between A Bank And Its Customer.

Throughout the draft Complaint, you make allegations suggesting that M&I participated in a conspiracy based on the mere fact that its bankers had periodic contact with representatives of the Petters organization to explore expanding the business relationship. This is nonsense. There is nothing remarkable, never mind nefarious, about bankers meeting with customers to explore business opportunities, especially when, as you point out, that customer has been revered as a pillar of the community. At the end of the day, however, these contacts are of no consequence. M&I's relationship with Petters never expanded beyond a handful of checking accounts with entities he controlled.

You Have Completely Ignored The Release And Indemnification Agreement.

Although the draft Complaint dwells on the Deposit Account Management Agreement (or "DAMA"), conspicuously and conveniently absent from the Complaint is any mention of the fact that at that same time Palm Beach entered into a Release and Indemnification Agreement "to induce" M&I to enter into the DAMA. Not only did that agreement expressly provide that M&I was entitled to rely on directions from Petters relating to the applications of any payment, but Palm Beach released and agreed to indemnify M&I from and against any and all claims relating to the transfer of payments from Petters to Palm Beach pursuant to the DAMA other than those "ultimately determined" to be based on M&I's "gross negligence or willful misconduct."

You Have Ignored The Obvious And Undisputed Reason Why M&I Did Not Inquire About The Lack Of Transaction Lists.

The draft Complaint notes that M&I never received any transaction lists from Petters pursuant to the DAMA and attempts to draw dire inferences from that fact. The inferences are wholly unwarranted. During this same period, Petters executed a "Book Transfer Agreement" authorizing Petters to move funds from the PCI account directly to the Palm Beach account at M&I. From M&I's perspective, this allowed Petters and Palm Beach to perform the functions contemplated by the DAMA without M&I's intervention—consistent with the backstop nature of the DAMA—while protecting Palm Beach because Petters could not take any money from the

Palm Beach account. Moreover, the transaction lists were to be sent to both Palm Beach and M&I. Palm Beach (which, as noted above, had executed a document giving M&I the right to rely on Petters' directions) never indicated any belief that a transaction had been misapplied or complained about not receiving transaction lists. Of course, why Palm Beach did not do so is now obvious—its principals were part and parcel of the Petters' scheme. But even ignoring that fact, the documents themselves do not call on M&I to do anything unless and until it receives a transaction list.

As noted above, this is only a sample of the various instances in which you have taken extreme liberties with the facts.

IN AND OF ITSELF, THE INTIMATE KNOWLEDGE OF AND INVOLVEMENT IN THE PETTERS' SCHEME BY PALM BEACH MANAGEMENT RENDERS THE COMPLAINT FRIVOLOUS.

Assuming only for purposes of argument that M&I did anything wrong, Harrold's and Prevost's knowledge of and involvement in the Petters' scheme would still preclude any recovery by Palm Beach, both as a matter of law and as a matter of fact.

1. *In Pari Delicto*

The equitable doctrine of *in pari delicto*—meaning, "in equal fault"—bars one wrongdoer from recovering against another. *See* BLACK'S LAW DICTIONARY 806 (8th ed. 2004). The doctrine is based on the policy that "courts should not lend their good offices to mediating disputes among wrongdoers." *Bateman Eichler v. Burner*, 472 U.S. 299, 306 (1985). *In pari delicto* is a commonly accepted defense and, in turn, is recognized under both Minnesota and Florida law.[1] *See State v. Aamco Auto Transmissions, Inc.*, 199 N.W.2d 44, 448 (Minn. 1972); *May v. Nygard Holdings Ltd.*, No. 6:03-cv-832-Orl-DAB, 2007 U.S. Dist. LEXIS 52605, at *9 (M.D. Fla. July 20, 2007).

A trustee in bankruptcy asserting claims on behalf of a debtor is subject to the same defenses as could be asserted had the debtor initiated the claim. *Bank of Marin v. England*, 385 U.S. 99, 100-01 (1966).[2] In fact, the Eleventh Circuit has recognized the applicability of *in pari*

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[1] The Complaint does not allege sufficient facts to engage in a meaningful choice of law analysis, so we cite cases from both jurisdictions.

[2] The principle recognized in *Bank of Marin* has been widely applied across the federal circuits. *See, e.g.*, *Grassmueck v. Am. Shorthorn Ass'n*, 402 F.3d 833, 836-37 (8th Cir. 2005); *Official Comm. of Unsecured Creditors v. R. F. Lafferty & Co.*, 267 F.3d 340, 356 (3rd Cir. 2001); *Hays & Co. v. Merrill Lynch*, 885 F.2d 1149, 1154 (8th Cir. 1989); *Murray v. Royal Alliance Assocs.*, 375 B.R. 208, 212-13 (M.D. La. 2007); *Gaudette v. Gaudette*, 241 B.R. 491, 498 (D. N.H. 1999); *Barber v. First Nat'l Bank*, 202 B.R. 267, 272 (C.D. Ill. 1996); *Smith v. O'Mara Enters., Inc.*, 100 B.R. 330, 337 (Bankr. S.D. Ohio 1989).

delicto to a trustee in the context of a Ponzi scheme. *Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145, 1150 (11th Cir. 2006) ("If the claim of [the debtor] would have been subject to the same defense of *in pari delicto* at the commencement of the bankruptcy, then the same claim, when asserted by the trustee, is subject to the same affirmative defense").

Indeed, the complicity of an investor's manager already has been held to bar claims by that investor arising out of this very Petters' scheme. As recognized in the draft Complaint ¶ 201, Lancelot Investors Fund, L.P. was PCI's largest investor. Like Palm Beach, Lancelot and its principal, Gregory Bell, were complicit in the Petters Ponzi scheme (*Id.* ¶¶ 200-02). Like Palm Beach, Lancelot was relegated to bankruptcy. And, like Palm Beach, the Lancelot trustee brought a complaint against another party (there, Lancelot's outside auditors) for failing to discover and/or prevent the scheme. It didn't work. In *Peterson v. McGladrey & Pullen, LLP*, No. 10-C-274, 2010 U.S. Dist. LEXIS 117018, at *1-2 (N.D. Ill. Nov. 3, 2010), the court, relying on decisions such as the Eleventh Circuit's opinion in *Edwards*, concluded that the "substantial weight of persuasive authority that favors allowing *in pari delicto* to be asserted against a trustee in bankruptcy," *id.* at *9-11 (collecting cases), and granted the auditors' motion to dismiss based on that defense.

Although neither your draft Complaint nor your previous correspondence acknowledge the *in pari delicto* obstacle, your selection of cases suggests that you anticipate the defense and intend to rely upon these so-called "adverse interest" exception to it. *See Tew v. Chase Manhattan Bank*, 728 F. Supp. 1551 (S.D. Fla. 1990). The exception is not applicable. As the district court concluded in *Peterson*, the Lancelot Funds "clearly benefitted from the alleged misconduct, even if the benefit was of 'limited duration'" and, accordingly, the "narrow" adverse interest exception did not apply. *Peterson* at *13. So, too, here. Although the actions of Harrold and Prevost may have ultimately harmed the investors in (technically, creditors of) Palm Beach, the irrefutable fact is that the two men's actions benefited the Funds for several years. Indeed, the draft Complaint acknowledges that the Palm Beach Funds and investors reaped steady profits for years until Petters payments slowed in late 2007, and the scheme collapsed in the fall of 2008.

Moreover, whatever the erstwhile applicability of the "adverse interest" exception, there is an exception *to it*: the "sole actor" doctrine. As explained by the United States Bankruptcy Court for the Southern District of Florida,

> Even if the agent's misconduct is calculated to benefit only the agent, to the detriment of its principal, imputation is still proper where the "sole actor" doctrine applies. . . . The "sole actor" doctrine provides that the adverse interest exception to the imputation rule is inapplicable where the transaction on behalf of the principal is entrusted solely to the officer or agent having the knowledge. . . . Where the officer in question is the sole representative of that corporation, there is

> no one to whom to impart his knowledge and no one from whom he may conceal it. . . . When a corporation has multiple officers and directors, the sole actor rule may apply when all relevant shareholders and decision-makers were involved in the fraud. . . . Courts thus consider whether there exist relevant decision-makers who are innocent of the fraud.

Phoenix Diversified Investment Corp. v. EfloorTrade, LLC, 439 B.R. 231, 242 (Bankr. S.D. Fla. 2010) (citations and internal punctuation omitted). Harrold and Prevost were in complete control of the Funds. You have not suggested, nor are we aware, of any decision-makers at either Fund who were innocent of the fraud.

In fact, Palm Beach's principals pled guilty in open court and actually *admitted* their involvement in the Petters fraud. The guilt of Palm Beach overwhelms any possible error on the part of M&I. To assert claims against M&I in the face of this undeniable truth will be sanctionable.

2. Negation of causation and reliance

Entirely aside from the legal bar of *in pari delicto*, the undeniable knowledge and involvement of Harrold and Prevost will make it impossible to sustain one or more critical elements of any claim of Palm Beach. Chief among these is causation. Given the involvement of Harrold and Prevost, nothing M&I could have done would have protected the Funds or their investors. The so-called "protections" were crafted by the very Palm Beach managers who were seeking to dupe those investors. If M&I had sensed that something was wrong with Petters' activities, under your theory to whom would it have reported? To Harrold and Prevost, of course, who, being in on the scheme, would undoubtedly have figured out some explanation to allay M&I's concern. They certainly would not have conveyed it to the very investors they had defrauded. Nor can Palm Beach conceivably be said to have "relied" on the expectation that M&I would protect them from Petters' potential wrongdoing when its principals were intent on achieving the opposite result. Once again any assertion to the contrary is utterly frivolous.

IT IS BEYOND LEGITIMATE DEBATE THAT M&I OWNED PALM BEACH NO DUTIES PRIOR TO FEBRUARY 25, 2008.

Under the prevailing if not universal rule of law, a bank does not owe third-party noncustomers a duty to protect them against the fraud of the bank's customers. For example, in the frequently cited case of *Guidry v. Bank of LaPlace*, 661 So. 2d 1052 (La. Ct. App. 1995), the court, reversing a jury verdict for the plaintiff, held that the defendant bank was not liable for failing to discover and prevent a Ponzi scheme carried out by one of the bank's customers in which the plaintiff had invested. *Id.* at 1059. This was so despite the fact that one of bank's loan officers had allegedly assured the plaintiff that the customer was long-standing and that there was nothing wrong with his account. *Id.* at 1059-60. According to the court, the bank "was

clearly under no duty to disclose information about its customer [the operator of the Ponzi scheme] to a non-customer." *Id.* at 1059. Further, the court conceded that "[r]esearch does not reveal, nor does logic suggest, any circumstances wherein a duty arises for a bank to independently investigate investments made by an experienced and sophisticated businessman." *Id.* This is the rule in Florida[3], Minnesota[4], Wisconsin (the state in which M&I is incorporated and has its principal place of business)[5] and, as far as we have been able to discern, all jurisdictions that have recently addressed the issue in at least the last two decades.[6]

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[3] *See, e.g., O'Halloran v. First Union National Bank*, 205 F. Supp. 2d 1296 (M.D. Fla. 2002), *vacated on other grounds*, 350 F.3d 1197 (11th Cir. 2003); *In re Meridian Asset Mgmt., Inc.*, 296 B.R. 243, 261-62 (Bankr. N.D. Fla. 2003) (bank owed no duty to third party victim of Ponzi scheme run by bank's depositor to analyze, investigate or to look behind the depositor's banking transactions); *Reimsnyder v. Southtrust Bank, N.A.*, 846 So. 2d 1264, 1267 (Fla. 4th DCA 2003) (bank not liable to third party for negligently misrepresenting that one of its customers was "a safe, secure, and reputable company"); *Sroka v. Compass Bank*, No. 2006-CA-001117, 2006 WL 2535656, at *1 (Fla. Cir. Ct. 2006) ("As a matter of law, a bank does not owe a duty to non-customers regarding the opening and maintenance of its accounts"); *Carl v. Republic Sec. Bank*, 282 F. Supp. 2d 1358, 1372 (S.D. Fla. 2003) (bank did not owe duty of care to third-party who claimed to have a right to funds in the account of a bank customer and, thus, was not liable for its alleged negligence in failing to follow its own procedures).

[4] *McCartney v. Richfield Bank & Trust Company*, Nos. CX-00-1466, C1-00-1467, 2001 Minn. App. LEXIS 451 (May 1, 2001) (Unpublished).

The case of *Richfield Bank & Trust Company v. Sjogren*, 309 Minn. 362, N.W.2d 648 (1976), a copy of which you sent to us on June 21, 2011, is not to the contrary. *Sjogren* held that a bank may have a duty to disclose a fraud perpetrated by its customer *only* when that bank has *actual knowledge* of the fraud, 309 Minn. at 369, which, as noted, M&I did not have. Furthermore, *Sjogren*, decided before 9/11, is of questionable precedence today. Under the Bank Secrecy Act and USA PATRIOT Act, banks are prohibited from disclosing to involved third-parties not only the content but the very existence of reports which detail potentially fraudulent account activity (so-called "suspicious activity reports," or SARS). *See* 31 U.S.C. § 5318(g)(2)(A)(i) (mandating the confidentiality of SARs); 31 U.S.C. § 5322 (imposing criminal penalties for improper disclosure). Thus, to the extent *Sjogren* requires banks to disclose evidence of fraud to third-parties, that holding is arguably preempted by federal law.

[5] *See, e.g., Hoida, Inc. v. M & I Midstate Bank*, 2006 WI 69, ¶¶ 39, 291 Wis. 2d 283, 717 N.W.2d 17 (affirming dismissal of negligence claims against lending bank and its disbursing agent); *Commercial Discount Corp. v. Milwaukee W. Bank*, 61 Wis. 2d 671, 687-688, 717 N.W.2d 17 (1974) (holding that bank had no duty to investigate whether customer's deposits were covered by security interest); *Grad v. Associated Bank, N.A.*, No. 10-AP-1461, ¶ 1 (Wis. Ct. App. June 7, 2011) ("We conclude dismissal of Grad's negligence claim was proper because a bank's duty of care to a noncustomer does not require the bank to affirmatively investigate a customer's activities for possible fraud.").

[6] *See, e.g., Renner v. Chase Manhattan Bank*, No. 98 Civ. 926 (CSH), 1999 U.S. Dist. LEXIS 978, at *40 (S.D.N.Y. Feb. 3, 1999) ("[I]t is well settled that a bank owes no . . . duty to a non-customer third-party [to prevent the bank's customer from defrauding that third party]."); *Tzaras v. Evergreen Int'l Spot Trading, Inc.*, No. 01 Civ. 10726 (LAP), 2003 WL 470611, at *5-6 (S.D.N.Y. Feb. 25, 2003) (under New York law, bank owed no duty of care to noncustomer for alleged negligence in accepting wire transfers and ignoring suspicious activities in account of customer in which plaintiff was fraudulently induced to invest); *Eisenberg v. Wachovia Bank, N.A.*, 301 F.3d 220, 224-27 (4th Cir. 2002) (North Carolina law; "Courts in numerous jurisdictions have held that a bank does not owe a duty of care to a noncustomer with whom the bank has no direct relationship"); *Weil v. First Nat'l Bank*, 983 P.2d

The reasons for the courts' conclusion are myriad and compelling. For example, imposing a duty on banks to inform third parties of suspicious customers would result in "loss of privacy, expense and commercial havoc . . .," *Software Design*, 56 Cal. Rptr. 2d at 763; *see also Chicago Title Ins. Co. v. Superior Court*, 220 Cal. Rptr. 507, 519 (Cal. Ct. App. 1985), would "unduly burden and hamper the operation of banks," *In re Meridian Asset Mgmt., Inc.*, 296 B.R. at 261 (quoting *Home Fed. Savs. & Loan Ass'n v. Emile*, 216 So. 2d 443 446 (Fla. 1968), and would "unreasonably expand banks' orbit of duty," *Century Bus. Credit Corp. v. N. Fork Bank*, 668 N.Y.S.2d 18, 19 (N.Y. App. Div. 1998), as well as "be contrary to the normal understanding of the purpose of a bank account." *Eisenberg*, 301 F.3d at 226 (citing *McCallum*, 1995 WL 1146812, at *3). Courts have concluded that it is better to place the burden of monitoring the fraudulent party on the investor who chose to do business with him; "[i]t is that person who has the most control and the most to win or lose, and with whom the investigative tasks should rest." *Software Design*, 56 Cal. Rptr. 2d at 763.

It is undisputed that, prior to February 2008, Palm Beach held no accounts whatsoever at M&I (*see* Compl. ¶ 137); the Debtors were simply third-party, noncustomers to which M&I could not, and did not, owe a duty of care. That being the case, to the extent you bring a claim which seeks damages for M&I's conduct prior to February 2008, it will be frivolous.

812, 814 (Colo. Ct. App. 1999) (Colorado law; bank did not owe duty of care to third-party to inquire into third-party employee's authority to open account); *Volpe v. Fleet Nat'l Bank*, 710 A.2d 661, 664 (R.I. 1998) (Rhode Island law; bank did not owe noncustomer payee duty to detect that her endorsement was forged); *Kesselman v. Nat'l Bank*, 937 P.2d 341, 345-46 (Ariz. Ct. App. 1996) (bank not liable for failure to disclose to bank customer's investors that customer was engaged in check kiting); *Miller-Rogaska, Inc. v. Bank One, N.A.*, 931 S.W.2d 655, 663-64 (Tex. Ct. App. 1996) (Texas law; banks owed no duty to noncustomer to protect against payment of misdelivered instrument); *Software Design & Application Ltd. v. Hoefer & Arnett, Inc.*, 56 Cal. Rptr. 2d 756, 759-63 (1996) (California law; bank had no duty to third-party defrauded by bank's customer with respect to opening of, or to deposit in or withdrawals from, customer's accounts); *McCallum v. Rizzo*, No. 942878, 1995 WL 1146812, at *2 (Mass. Super. Ct. Oct. 13, 1995) ("The mere fact that a bank account can be used in the course of perpetrating a fraud does not mean that banks have a duty to persons other than their own customers. To the contrary, the duty is owed exclusively to the customer, not to the persons with whom the customer has dealings"); *E.F. Hutton Mortgage Corp. v. Equitable Bank, N.A.*, 678 F. Supp. 567, 583 (D. Md. 1988) ("mere negligence on the part of a bank in failing to detect a fiduciary's wrongdoing is not actionable"); *Portage Aluminum Co. v. Kentwood Nat'l Bank*, 307 N.W.2d 761, 764 (Mich. Ct. App. 1981) (Michigan law; bank owed no duty to third-parties dealing with bank's customer; "[i]t is generally no business of a bank to pry into the affairs of depository customers to determine who the customers of the depositor are or to act on behalf of such persons"); *Pa. Nat'l Turf Club Inc. v. Bank of W. Jersey*, 385 A.2d 932, 936 (N.J. Super. Ct. App. Div. 1978) (Pennsylvania law; bank owed no duty to third-parties to protect against customer's fraudulent scheme).; *see also Cumis Ins. Soc'y, Inc. v. Windsor Bank & Trust Co.*, 736 F. Supp. 1226, 1232-36 (D. Conn. 1990) (collecting cases).

NOR IS THERE ANY REASON TO BELIEVE THAT ANY ALLEGED BREACH OF DUTY AFTER FEBRUARY 26, 2008 CAUSED PALM BEACH ANY HARM.

Although it is true that on February 25, 2008, M&I entered into the DAMA (as well as the Release and Indemnification Agreement with PBFP Holdings, LLC), it breached no duty of the agreement, nor could any hypothetical breach possibly have caused Palm Beach damage under these circumstances. There are a variety of reasons for this, chief among which are the following:

Whatever duties M&I may have owed after February 25, 2008 were never triggered.

As noted above, M&I's duty was merely to redirect funds if and when it received a transaction list. It never received any such list, a fact well known to Palm Beach's principals. Nor have you identified any instance in which a transfer was in fact misrouted and, hence, would have fallen to M&I to re-route. Indeed, as a result of the Book Transfer Agreement, between February 25, 2008 and September 2008, almost $250,000,000 flowed from the PCI account to the Palm Beach account at M&I. And, by express agreement, Palm Beach authorized M&I to rely on Petters' directions. As a matter of simple contract law, M&I was never required to take any action.

You have not suggested any way in which either Palm Beach or its investors actually relied on anything M&I said.

How could the Funds have relied on either M&I's assumption of duties under the DAMA or its alleged misrepresentation of its intent to perform thereunder? The principals of Palm Beach were fully aware of Petters' scheme. It was their intent that M&I not be able to detect the fraud, and any contention that the Funds "relied" on M&I to do so is spurious.

Petters was already insolvent by February 25, 2008.

Put bluntly, by the time M&I entered into the DAMA, the patient was already dead. As Palm Beach's principals well knew, months before February 25, 2008, Petters no longer had the ability to make any payments on his obligations to the Funds. That is why they exchanged one billion dollars of worthless paper for another billion dollars of worthless paper. At most, $76 million of new money was invested into Palm Beach after February 25, 2008. That being the case, and indulging in every other assumption in favor of the Funds no matter how unfounded or unreasonable, there was nothing M&I could have done to save the Funds from loss. Any assertion to the contrary is unmitigated fiction.

You have glossed over the fact that only one of the two Funds was listed as a protected party in the DAMA.

The DAMA lists only one of the two Funds, Palm Beach Finance Partners, LP, as a protected party. (It also lists PBFB Holdings LLC and Palm Beach Capital Corp., but these are not your clients.) Notably, over 80% of the phony paper issued by Palm Beach appears to be held by PBF II, which is not listed as a protected party, yet you appear to be making a claim for all of it. This, too, is frivolous. *Cf. Jones v. International Riding Helmets*, 49 F.3d 692 (11th Cir. 1995) (sanctions were warranted where plaintiff knew the defendant was not the correct party, but glossed over facts in the complaint).

Palm Beach Released M&I.

Finally, as noted above, the release and indemnification agreement released M&I from any and all damages incurred as a result of any transaction conducted or service provided by M&I pursuant to the DAMA. Although the release excepts claims based upon M&I's gross negligence or willful misconduct, for all the reasons discussed above, M&I is guilty of neither.

YOUR OTHER CLAIMS SUFFER FROM A VARIETY OF ADDITIONAL DEFECTS.

The foregoing fault lines cut across all of the claims in the draft Complaint. Nevertheless, we note yet additional defects not already discussed.

Fraudulent Transfer

Under 11 U.S.C. § 550, a trustee can only recover from an initial transferee. Where a bank receives money for the sole purpose of depositing it into its customer's account, the bank is a mere conduit, not an initial transferee and the trustee cannot recover funds from it. *See, e.g., In re Columbian Coffee, Inc. v. First Alabama Bank of Mobil*, 75 B.R. 177, 179 (S.D. Fla. 1987); *see also In re Tousa, Inc.*, 444 B.R. 613, 672 (S.D. Fla. 2011).

Although a party who did not act in good faith may not be deemed a "mere conduit," failure to act in good faith appears to require actual knowledge of the fraudulent scheme in question. *See, e.g., In re Baker & Getty*, 98 B.R. at 308-09 (holding bank did not act in good faith when it accepted payment from debtor after revelation of Ponzi scheme); *In re Torcise*, 116 F.3d 860, 867 (11th Cir. 1997) (holding bank was not acting in good faith when it was aware of scheme and fact that debtor was insolvent). As noted above, there is no evidence of knowledge or bad faith on the part of M&I, while the debtor's knowledge is undisputed.

Minnesota Consumer Fraud Act

Any attempt to state a claim under the Minnesota Consumer Fraud Act is untenable for a variety of reasons, only a few of which we will note here.

First, the Minnesota Supreme Court has held that private actions under the Act may not be based on alleged misrepresentations made only to the plaintiff and not to the general public. Thus, this statute provides no relief. *Ly v. Nystrom*, 615 N.W.2d 302, 314 (Minn. 2000). Moreover, representations made to the public at large are not actionable in the absence of any nexus between the misrepresentations and the actual transaction in question. *See, e.g., Antioch Co. v. Scrapbook Boards, Inc.*, 291 F. Supp. 2d 980, 1003 (D. Minn. 2003); *Flora v. Firepond, Inc.*, 260 F. Supp. 2d 780, 787 (D. Minn. 2003). Here, none of the alleged misrepresentations related to the transaction were made to any party other than the Funds and certainly not to the public at large; indeed, the Complaint touts that the service is contemplated under the DAMA were "special and extraordinary." *See, e.g.*, draft Complaint ¶ 142.

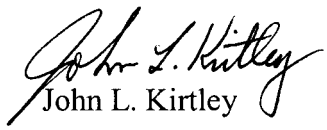
Moreover, the Minnesota Consumer Fraud Act does not provide relief to sophisticated investors or merchants. *See, e.g., Ly*, 615 N.W.2d at 308, 310; *Stephenson v. Deutsche Bank AG*, 282 F. Supp. 2d 1032, 1069-70 (D. Minn. 2003) (dismissing broker-dealer's Consumer Fraud Act claims). A hedge fund certainly qualifies as a sophisticated investor.

CONCLUSION

We urge you to reflect long and hard before filing the draft Complaint. The debtor Funds and their principals were well aware of and, indeed, part and parcel of the Petters' scheme. That fact, as well as myriad other defects discussed above, renders any attempt to sue M&I frivolous. M&I will proceed under Rule 9011 if the Complaint is filed.

Best regards,

GODFREY & KAHN, S.C.



John L. Kirtley

JLK:bss/clr
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SCENARIO 1		Class A Greenpond (Acorn)	Class A Ritchie[1]	Class A Ark Discovery[1]	Class A Interlachen	Class A Apriven Partners	Class A Ark Royal Capital[1]	Class A Elistone Fund	Class A Ted Deikel	Class A True North Funding	Class A C&C Capital	Class A Other Claims (est.)[2]	Class A Total	Class B Lancelot Funds	Class C Palm Beach	Total
	Estimated Claim	$141,000,000	$78,500,000	$55,000,000	$60,000,000	$32,000,000	$15,150,000	$10,000,000	$8,222,543	$3,600,000	$1,500,000	$95,027,457	$500,000,000	$764,000,000	$641,000,000	$1,905,000,000
Assumes $250mm pot and	% Dist.															
1.) first $100 mm paid to Class A only	20.00%	$28,200,000	$15,700,000	$11,000,000	$12,000,000	$6,400,000	$3,030,000	$2,000,000	$1,644,509	$720,000	$300,000	$19,005,491	$100,000,000			$100,000,000
2.) next $50 mm paid to Classes A & B only	3.96%	$5,577,532	$3,105,222	$2,175,633	$2,373,418	$1,265,823	$599,288	$395,570	$325,259	$142,405	$59,335	$3,758,998	$19,778,481	$30,221,519		$50,000,000
3.) Balance of $100 mm paid to Classes A, B & C	5.25%	$7,401,575	$4,120,735	$2,887,139	$3,149,606	$1,679,790	$795,276	$524,934	$431,630	$188,976	$78,740	$4,988,318	$26,246,719	$40,104,987	$33,648,294	$100,000,000
		$41,179,106	$22,925,956	$16,062,772	$17,523,024	$9,345,613	$4,424,564	$2,920,504	$2,401,397	$1,051,381	$438,076	$27,752,807	$146,025,200	$70,326,506	$33,648,294	$250,000,000

SCENARIO 2		Class A Greenpond (Acorn)	Class A Ritchie*	Class A Ark Discovery*	Class A Interlachen	Class A Apriven Partners	Class A Ark Royal Capital*	Class A Elistone Fund	Class A Ted Deikel	Class A True North Funding	Class A C&C Capital	Class A Other Claims (est.)	Class A Total	Class B Lancelot Funds	Class C Palm Beach	Total
	Estimated Claim	$141,000,000	$78,500,000	$55,000,000	$60,000,000	$32,000,000	$15,150,000	$10,000,000	$8,222,543	$3,600,000	$1,500,000	$95,027,457	$500,000,000	$764,000,000	$641,000,000	$1,905,000,000
Assumes $250mm pot and	% Dist.															
1.) first $100 mm paid to Class A only	20.00%	$28,200,000	$15,700,000	$11,000,000	$12,000,000	$6,400,000	$3,030,000	$2,000,000	$1,644,509	$720,000	$300,000	$19,005,491	$100,000,000			$100,000,000
2.) next $60 mm paid to Classes A & B only	4.75%	$6,693,038	$3,726,266	$2,610,759	$2,848,101	$1,518,987	$719,146	$474,684	$390,311	$170,886	$71,203	$4,510,797	$23,734,177	$36,265,823		$60,000,000
3.) Balance of $90 mm paid to Classes A, B & C	4.72%	$6,661,417	$3,708,661	$2,598,425	$2,834,646	$1,511,811	$715,748	$472,441	$388,467	$170,079	$70,866	$4,489,486	$23,622,047	$36,094,488	$30,283,465	$90,000,000
		$41,554,455	$23,134,927	$16,209,185	$17,682,747	$9,430,798	$4,464,894	$2,947,124	$2,423,286	$1,060,965	$442,069	$28,005,775	$147,356,224	$72,360,311	$30,283,465	$250,000,000

SCENARIO 3		Class A Greenpond (Acorn)	Class A Ritchie*	Class A Ark Discovery*	Class A Interlachen	Class A Apriven	Class A Ark Royal	Class A Elistone Fund	Class A Ted Deikel	Class A True North	Class A C&C Capital	Class A Other Claims	Class A Total	Class B Lancelot Funds	Class C Palm Beach	Total
	Estimated Claim	$141,000,000	$78,500,000	$55,000,000	$60,000,000	$32,000,000	$15,150,000	$10,000,000	$8,222,543	$3,600,000	$1,500,000	$95,027,457	$500,000,000	$764,000,000	$641,000,000	$1,905,000,000
Assumes $250mm pot and	% Dist.															
1.) first $100 mm paid to Class A only	20.00%	$28,200,000	$15,700,000	$11,000,000	$12,000,000	$6,400,000	$3,030,000	$2,000,000	$1,644,509	$720,000	$300,000	$19,005,491	$100,000,000			$100,000,000
2.) next $75 mm paid to Classes A & B only	5.93%	$8,366,297	$4,657,832	$3,263,449	$3,560,127	$1,898,734	$898,932	$593,354	$487,888	$213,608	$89,003	$5,638,496	$29,667,722	$45,332,278		$75,000,000
3.) Balance of $75 mm paid to Classes A, B & C	3.94%	$5,551,181	$3,090,551	$2,165,354	$2,362,205	$1,259,843	$596,457	$393,701	$323,722	$141,732	$59,055	$3,741,238	$19,685,039	$30,078,740	$25,236,220	$75,000,000
		$42,117,479	$23,448,383	$16,428,804	$17,922,331	$9,558,577	$4,525,389	$2,987,055	$2,456,119	$1,075,340	$448,058	$28,385,226	$149,352,761	$75,411,019	$25,236,220	$250,000,000

[1] Ritchie, Ark Discovery and Ark Royal Capital claims are estimated at 50% of the amounts asserted on their proofs of claim.

[2] The 'Other Claims' includes estimated trade claims, both scheduled and as asserted in proofs of claim, of approximately $4 million as well as the balance of the Ritchie and Ark claims.

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Creditor List

Click the link above to produce a complete list of **creditors** only.

List of Creditors

Click on the link above to produce a list of **all** creditors and **all** parties in the case. User may sort in columns or raw data format.