UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF MISSISSIPPI
NORTHERN DIVISION

SECURITIES AND EXCHANGE COMMISSION Plaintiff, v. ARTHUR LAMAR ADAMS AND MADISON TIMBER PROPERTIES, LLC Defendants.	Case No. 3:18-cv-252-CWR-FKB Hon. Carlton W. Reeves, District Judge Hon. F. Keith Ball, Magistrate Judge

OBJECTION AND COMMENT TO FIRST PROPOSED DISTRIBUTION

BankPlus and BankPlus Wealth Management LLC (collectively "BankPlus") do not want to stand in the way of the Receiver's laudable goal of making a large distribution quickly. To that end, BankPlus does not object to the payment of "Priority 1" claims proposed by the Receiver's Motion to Approve First Distribution.[1] But because the Receiver's proposed equitable advances and future payments of Priority 2 and 3 claims might affect damages calculations in the Receiver's case against BankPlus, BankPlus brings this Objection. BankPlus seeks to avoid any estoppel or waiver argument in the Receiver's case against BankPlus on the calculation of damages. BankPlus therefore objects here to the Receiver's position that she can recover and distribute damages for net winners, as well as interest on fraudulent and void promissory notes. The Court need not address these issues to approve the payment of Priority 1 claims.

BankPlus does not object to the payment of Priority 1 losses because the law supports payment for investors' unpaid principal. But as the court-appointed receiver for Arthur Lamar

[1] Doc. 264; supporting memorandum at Doc. 265.

Adams ("Adams") and Madison Timber Properties, LLC ("Madison Timber"), the Receiver must settle the debts *of the Receivership estate*. Under well-established Fifth Circuit precedent, a Ponzi receivership's debts do not include interest purportedly owed to investors under the terms of their investments. Thus, the total amount of Madison Timber investors' unpaid principal constitutes the complete debt of the Receivership—in other words, $46.5 million is the combined limit of the Receiver's recovery across all her cases.

LAW AND ARGUMENT

Priority 2 and 3 Claims: Parties Cannot Enforce Terms of Ponzi Contracts or Claim Interest

The Distribution Motion reveals the Receiver seeks to enforce the terms and conditions of investors' Madison Timber promissory notes. This she cannot do: consistent with every federal appellate court to consider the issue, the Fifth Circuit has already rejected the notion of Ponzi contracts' enforceability in cases arising from the Stanford Ponzi scheme.[2] Because the inherently fraudulent nature of a Ponzi scheme negates any written contractual relief for investors, the law instead applies general contract principles to interest and principal payments made by the scheme.

The lynchpin of this framework is whether the Ponzi scheme issued its payments in exchange for "reasonably equivalent value" (consideration) from the transferee.[3] The law considers each principal payment by the Ponzi scheme to a good-faith investor as payment of a

[2] *Janvey v. Brown*, 767 F.3d 430, 440-1 (5th Cir. 2014) (applying provisions of Texas' Uniform Fraudulent Transfer Act also present in Mississippi's version, and agreeing with district court that "only claim that [investors] have for their interest payments is a contractual one, which [] is unenforceable…. [T]here is no valid claim for interest; the CDs issued by [Stanford] are void and unenforceable."); *Sender v. Buchanan (In re Hedged-Investments Assocs.)*, 84 F.3d 1286, 1290 (10th Cir. 1996) (Ponzi contracts unenforceable as matter of public policy to extent contracts provide excess returns to investors).

[3] *See generally Scholes v. Lehmann*, 56 F.3d 750, 756-8 (7th Cir. 1995) (Posner, J.) ("principles of *Scholes* and its progeny" applied by *Janvey v. Democratic Senatorial Campaign Comm., Inc*., 712 F.3d 185, 192 (5th Cir. 2013)).

legitimate debt owed by the scheme to the investor. The "debt" is not contractual, but arises by operation of law: it is the fraud claim the good-faith investor possesses as a victim of the Ponzi scheme. In other words, when a good-faith investor invests in a Ponzi scheme, that investor has in fact purchased a cause of action for fraud against the scheme. When the scheme issues a principal payment, it extinguishes the investor's cause of action for those funds, making the principal payment valid under the law.[4] BankPlus thus does not object to the Priority 1 claims' payment.[5]

For interest in a Ponzi scheme, on the other hand, the underlying debt is inherently void and unenforceable.[6] Any interest paid out by a Ponzi scheme must, by its nature, derive from

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[4] *Janvey v. Brown*, 767 F.3d at 443. ("[P]rincipal payments made to the investor-defendants are not subject to [fraudulent transfer] claims. Unlike interest payments, it is undisputed that the principal payments were payments of an antecedent debt, namely fraud claims that the investor-defendants have as victims of the Stanford Ponzi scheme."); *Picard v. Gettinger (In re Bernard L. Madoff Inv. Sec. LLC)*, 976 F.3d 184 (2d Cir. 2020) (considering Securities Investor Protection Act and Bankruptcy Code's fraudulent-transfer corollaries and affirming summary judgment that denied investors' claims to profits); *Perkins v. Haines*, 661 F.3d 623, 627 (11th Cir. 2011) ("In the case of Ponzi schemes, the general rule is that a defrauded investor gives 'value' to the Debtor in exchange for a return of the principal amount of the investment, but not as to any payments in excess of principal."); *Donell v. Kowell*, 533 F.3d 762, 777-78 (9th Cir. 2008) ("Up to the amount that 'profit' payments return the innocent investor's initial outlay, these payments are settlements against the defrauded investor's restitution claim. Up to this amount, therefore, there is an exchange of 'reasonably equivalent value' for the defrauded investor's outlay. Amounts above this, however, are merely used to keep the fraud going by giving the false impression that the scheme is a profitable, legitimate business. These amounts are not a 'reasonably equivalent' exchange for the defrauded investor's initial outlay."). *See also Warfield v. Carnie*, 2007 U.S. Dist. LEXIS 27610, at *36 (N.D. Tex. Apr. 13, 2007) ("As the Receiver correctly notes, a Ponzi scheme investor who receives an amount in excess of his or her initial investment has received two types of payments—(1) a full return of the principal investment and (2) amounts received in excess of the initial investment, i.e., 'fictitious profits.' The vast majority of courts that have considered the issue have held that a debtor does not receive reasonably equivalent value for any payments made to investors that represent false profits.").

[5] BankPlus reserves its right to contest the Receiver's calculations if discovery reveals any errors or deviation from the process described in the Distribution Motion, or a failure by the Receiver to conduct the required good-faith analysis necessary to determine investors' eligibility for payment.

[6] *See Official Stanford Inv'rs Comm. v. Am. Lebanese Syrian Associated Charities*, 2015 U.S. Dist. LEXIS 199408, at *29 (N.D. Tex. July 22, 2015) ("contracts with a Ponzi scheme are void and unenforceable"); *Janvey v. Alguire*, 2013 U.S. Dist. LEXIS 82568, at *65-66 (N.D. Tex. Jan. 22, 2013) ("Holding that a Ponzi scheme investor may recover payments made up to his principal investment is consistent with the vast majority of courts addressing the issue.") (*affirmed by Janvey v. Brown*); *Sec. Inv'r Prot. Corp. v.*

converted funds of other investors and not from any legitimate assets owned by the scheme. Moreover, the Fifth Circuit in *Janvey v. Brown* rejected the reasoning of outlier cases that support payment of reasonable contractual interest to Ponzi investors.[7]

Bernard L. Madoff Inv. Sec. LLC (In re Madoff Sec.), 476 B.R. 715, 725 (S.D.N.Y. 2012) "[E]very circuit court to address this issue has concluded that an investor's profits from a Ponzi scheme, whether paper profits or actual transfers, are not for value."); *In re Bayou Group, LLC*, 362 B.R. 624, 635 (Bankr. S.D.N.Y. 2007) (collecting cases) (cited with approval by *Janvey v. Alguire*). Internal citations, punctuations, and quotations omitted.

[7] *Brown* at 441, citing and rejecting reasoning articulated in *Daly v. Deptula (In re Carrozzella & Richardson)*, 286 B.R. 480 (D. Conn. 2002). The Second Circuit has expressed doubts on the holding in *Carrozzella,* calling it an "outlier" case:

> Cullin relies on two outlier cases where guaranteed interest payments at a commercially reasonable rate made in satisfaction of an antecedent debt were found to constitute fair consideration. *See In re Carrozzella & Richardson, 286 B.R. 480, 487-90 (D. Conn. 2002); In re Unified Commercial Capital*, No. 01-MBK-6004L, 2002 U.S. Dist. LEXIS 28721, 2002 WL 32500567 at *8 (W.D.N.Y. June 21, 2002). We need not decide whether those cases were correctly decided. Even if they were, Cullin cannot benefit from their holdings because the interest on her investment was not guaranteed and was in excess of commercially reasonable rates.

Silverman v. Cullin, 633 F. App'x 16, 17-18 (2d Cir. 2016).

Carrozzella and other outlier cases that permit payment to net winners appear nevertheless to (1) limit retention of net winnings to "reasonable" interest, (substantially less than the nominal 12-13% that MTP promised investors); and, (2) require that net winners have acted in good faith. Thus, even the few cases supporting the proposed distribution compel fact inquiries and call for depositions into investors' sophistication, knowledge, and experience, and the circumstances of their investment. *See generally Lewis v. Taylor*, 2018 CO 76, 427 P.3d 796 (Colo. 2018) (ruling that for equity schemes, time value to money cannot apply to give investors a claim to profits; for schemes involving contractual rights to interest, investors can claim some portion of profits under a time value to money theory due to contractual nature of scheme); *Mukamal v. Mansour (In re Palm Beach Fin. Partners, L.P.)*, 2013 Bankr. LEXIS 5761, at *28-29 (Bankr. S.D. Fla. Sep. 12, 2013) (gathering cases and noting "ample" caselaw applying "Scheme-Based" approach that "accept[s] the premise that contracts with Ponzi schemes are *per se* void and unenforceable," but deferring under *Erie* doctrine to Minnesota state appeals court decision endorsing reasonable contractual interest under "Discrete Transaction" approach) (consistent with the Minnesota Supreme Court's later opinion in *Finn v. All. Bank*, 860 N.W.2d 638 (Minn. 2015)); *Okla. Dep't of Sec. ex rel. Faught v. Blair*, 2010 OK 16, 231 P.3d 645 (Ok. 2010) (not considering OUFTA) (permitting clawback of "artificially high" returns, but on grounds of equity rejecting receiver's attempts to claw back "reasonable" profits); *Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, LLC (In re Bayou Grp., LLC)*, 439 B.R. 284, 337 (S.D.N.Y. 2010) (rejecting investors' affirmative defense regarding clawback of profits in part because *Carrozzella* and other cases were "distinguishable, however, because they involved commercially reasonable, contractually guaranteed rates of return.") (gathering cases).

A receivership's debts thus exclude investors' claims for interest.[8] BankPlus therefore objects to the Receiver's proposed plan to pay contractual interest to Priority 2 and 3 claimants.

Equitable Advances: Equity Cannot Displace Substantive Law

No matter how well intentioned or how comparatively small, the proposed equitable advances are no more permissible than interest payments, because neither the Receivership nor any defendant owes these investors any legitimate debts under the law.

The Receiver relies on equity, but equity can only supplement—not supplant—applicable substantive law.[9] Furthermore, the Fifth Circuit found equity *disfavored* payments to investors who received more from the Stanford Ponzi scheme than they lost:

> The district court noted that this leads to an equitable result, because for victims of a Ponzi scheme, everyone is a loser. . . . Allowing Net Winners to keep their fraudulent above-market returns in addition to their principal would simply further victimize the true Stanford victims, whose money paid the fraudulent interest.[10]

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[8] The Stanford Receiver's first distribution recognized this limitation. *See* Case 3:09-cv-00298-N, Doc. 1877, at 5 (defining investors' "Net Loss" as "the amount of money paid to Stanford International Bank, Ltd. by an Investor CD Claimant **in excess of the amount of money received** from Stanford International Bank, Ltd. by the Investor CD Claimant."). Emphasis added.

[9] *SEC v. Stanford Int'l Bank, Ltd.*, 927 F.3d 830, 842 (5th Cir. 2019) ("[F]ederal district courts have no greater authority in equity receiverships to ignore [] bedrock propositions, because a court in equity may not do that which the law forbids."); *Armstrong v. Exceptional Child Ctr., Inc.*, 575 U.S. 320, 327-28 (2015) ("Courts of equity can no more disregard statutory and constitutional requirements and provisions than can courts of law."); *Reed v. City of Arlington*, 795 F. Supp. 2d 465, 477 (N.D. Tex. 2008) ("It is a fundamental maxim that equity must follow the law. A court of equity has no more right than has a court of law to act on its own notion of what is right in a particular case[.] Thus, a court of equity is bound by any explicit statute or directly applicable rule of law, regardless of its view of the equities. Equity courts cannot disregard, or in effect repeal, statutory and constitutional requirements and provisions."). Internal citations, punctuations, and quotations omitted.

[10] *Brown* at 441. *See also Alguire* at 70-71.

Here, the proposed recipients of the equitable advances are those who "received, over time, interest that exceeds any principal still due to them under their promissory notes."[11] The Receiver's proposed equitable advances therefore divert money away from the Receivership's valid debts—investors' unpaid principal.

Only Good-Faith Investors Possess Claims against the Receivership

Even the outlier cases agree with the Fifth Circuit that only investors who acted in good faith may retain or receive reasonable contractual interest.[12] No individual investing with knowledge of the scheme's unlawful purpose has valid claims against the receivership; in fact, a receivership has claims against these bad-faith investors for any interest *and principal* payments they received from the scheme because their knowing participation perpetuated the fraud.[13]

BankPlus' Motion to Dismiss the Receiver's case against it remains pending, and no discovery has taken place. As a result, BankPlus cannot know whether the Receiver inquired into the investors' good faith, and her Distribution Motion does not address this requirement.[14] But

[11] Distribution Motion at 12.

[12] *See supra*, n. 7; *Janvey v. Brown*, 767 F.3d at 440 (transfers not voidable against persons taking "**in good faith** and for a reasonably equivalent value"). Emphasis added.

[13] *See Scholes*, 56 F.3d at 757.

[14] The Fifth Circuit employs a fact-specific, reasonableness standard to determine good faith, requiring courts to ask (1) did the transferee have information that would make a reasonable person suspicious the transaction might be fraudulent, and (2) if so, did the transferee conduct a diligent investigation? The Fifth Circuit has not adopted a strict definition of "good faith," instead directing judges to focus on the factual circumstances of each transfer with a two-part test:

(1) Did the transferee possess information placing it on "inquiry notice" that the transfer might be fraudulent, or the transferor insolvent? That is, would an objectively reasonable investor under the circumstances suspect fraud or insolvency and inquire further? *Templeton v. O'Cheskey (In re Am. Hous. Found.),* 785 F.3d 143, 164 (5th Cir. 2015) ("a court should focus on the circumstances specific to the transfer at issue—that is, whether a transferee reasonably should have known . . . of the fraudulent intent underlying the transfer.").

across her cases, the Receiver ascribes knowledge of Madison Timber's fraudulent purpose to defendants based on "red flags"—*available to all investors*—that, "taken together clearly evidence a fraud."[15] Those red flags included unreasonably high returns, here over 20% per annum real yield.[16]

If the Receiver's complaints sufficiently allege defendants' knowledge of fraud, then the Receivership has no debt to any investor with access to those same red flags.[17] Knowledge of the scheme's unlawful purpose bars recovery for the bad-faith investors and subjects them to clawback of both their fictitious profits and their invested principal.[18] For these reasons, BankPlus reserves

(2) If on inquiry notice, did the transferee conduct a "diligent investigation"? If a transferee fails to make an inquiry where he has a duty to do so, he will be charged with all the knowledge that he would have acquired had he conducted the investigation. *Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, LLC (In re Bayou Grp., LLC)*, 439 B.R. 284, 313 (S.D.N.Y. 2010) (internal citation omitted) (case quoted by *Templeton* at 164). Although the case law "is not clear as to the nature of this requirement," courts apply an objective reasonableness standard (the "reasonable investor" standard) to determine the sufficiency of an investigation's diligence, just as they apply it to the inquiry notice prong of the good faith analysis. *Id*. at 312.

[15] *E.g.*, Case 3:19-cv-00196-CWR-LRA, Doc. 71 at 17-18.

[16] *Id*., at 17. MTP initially sold its notes at a 12% discount to face value, later 13%. Because they initially paid in 12 equal monthly installments over one year, later over 13 months, but skipped December, the real interest rate was much higher.

Furthermore BankPlus disputes the propositions that (1) red flags evidence actual knowledge, and (2) the Receiver may base her claims on some sort of constructive knowledge. *See* BankPlus' Motion to Dismiss and Reply in support, Case 3:19-cv-00196-CWR-LRA, Docs. 77 (at 10-12) and 109 (at 12-14).

[17] The Receiver sues BankPlus under several theories of secondary liability (conspiracy, aiding and abetting, *etc*.). To prevail, she must first establish a primary violation: MTP's fraud. That, in turn, establishes the existence of valid Receivership debt forming the basis for any alleged secondary liability. No bad-faith investor holds any claim against the Receivership and thus cannot provide standing for the Receiver to assert secondary liability claims against third parties. *See Isaiah v. JPMorgan Chase Bank, N.A.*, 960 F.3d 1296, 1306 (11th Cir. 2020) ("It is axiomatic that a receiver obtains only the rights of action and remedies that were possessed by the person or corporation in receivership").

[18] BankPlus does not know the identities of all the investors because the Receiver has treated this as confidential, and BankPlus has not engaged in discovery. Nevertheless, given that Lamar Adams focused his sales efforts on members of country clubs, this list may include attorneys and financial professionals, perhaps even ones who work for other defendants. *See Mills v. Butler Snow, et al.*, Case 3:18-cv-00866-CWR-FKB, Doc. 1 at 32 (the Receiver's complaint, quoting Brent Alexander about Adams: "Everyone

its right to object to the Priority 1 payments if discovery later reveals no good-faith analyses necessary to determine each investor's eligibility for payment.

CONCLUSION

Of course, BankPlus commends the Receiver's efforts to repay valid receivership debts to all good-faith Madison Timber investors for the fraud Lamar Adams committed against them. Nevertheless, the Receivership's plan to make equitable advances and to pay Priority 2 and 3 claims appears to pay more than the valid debts of the Receivership. Out of an abundance of caution to avoid any waiver of argument, BankPlus objects to the Receiver's enforcement of the Madison Timber notes and to the Receiver's proposed equitable advances, because Fifth Circuit caselaw rejects the enforceability of Ponzi contracts and limits receivership recoveries to principal investments.

Respectfully submitted,

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knew him. Country club fixture."). If this is the case, then good faith inquiries become all the more important.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the above and foregoing pleading has been served on all parties and/or their counsel of record, by e-mail, by ECF, facsimile, by-hand, and/or by United States mail.

New Orleans, Louisiana, this 12th day of May, 2021.

/s/ Alexander N. Breckinridge, V
Alexander N. Breckinridge, V