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Eleventh Circuit Limits Bank Liability in Ponzi Schemes

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Anyone who has read a Carl Hiaasen novel or watched an episode of *Miami Vice* knows that South Florida is a hotbed of fraudulent enterprises and Ponzi schemes. Not surprisingly then, courts in the Eleventh Circuit have been at the forefront of charting the scope of liability for unwitting participants in these schemes, with particular focus on fraudulent transfer and aiding and abetting liability.

In *Isaiah v. JPMorgan Chase Bank*, 960 F.3d 1296 (11th Cir. 2020), the Eleventh Circuit held for the first time that routine withdrawals and deposits into and out of a retail bank account are not "transfers" within the meaning of Florida's Uniform Fraudulent Transfer Act ("FUFTA"). The ruling reinforces well-settled Florida law protecting banks from liability for their customers' tortious conduct. It serves as strong new precedent undermining recent efforts to treat a customer's transfers into and out of depository accounts as fraudulent transfers.

Background

The facts were similar to many fraudulent schemes in which fraudsters use commercial bank accounts to manage a fraudulent business. The principals of two entities, Coravca Distributions, LLC and Time Trading Corp. (the "Entities") carried out a Ponzi scheme by soliciting investors with the promise of astronomical returns on investments in the trade of Venezuelan and U.S. currency. As with other classic Ponzi schemes, investors' money was never invested in a legitimate enterprise, and was instead used to pay other investors to dupe them into believing they were receiving gains on their investments. The Entities' principals ultimately defrauded over 2,000 investors and stole millions of dollars. The fraudsters deposited investor funds and made alleged distributions through deposit accounts at J.P. Morgan Chase ("JPMC"). Although JPMC's internal anti-money laundering personnel detected suspicious activity and closed the Entities' accounts in May 2010, the bank allowed the Entities to open two new accounts less than a day later, which allowed the principals to "wind down their affairs" and to transfer funds to different banks.

Amir Isaiah, the court-appointed receiver of the Entities (the "Receiver"), brought claims in the Florida district court against JPMC for (i) avoidance and recovery of the deposits, withdrawals, and transfers among the Entities' JPMC accounts as fraudulent transfers under the FUFTA, and (ii) damages for aiding and abetting the Ponzi schemers' breach of fiduciary duties, conversion, and fraud. The

Receiver alleged that JPMC "acted in bad faith in processing bank transactions" on behalf of the Entities, violated banking rules and regulations, and willfully ignored suspicious banking activity, all of which allowed the principals to perpetrate the Ponzi scheme for years.

The district court granted JPMC's motion to dismiss on November 14, 2017. *Isaiah v. JPMorgan Chase Bank, N.A.*, Civ. No. 16-21771, 2017 WL 5514370 (S.D. Fla. Nov. 14, 2017). With respect to the Receiver's claim under the FUFTA, the court found that that "the Receiver does not allege that JPMC did anything more than routine banking for the Ponzi Schemers." *Id*. at *2. Relying on the Eleventh Circuit's decision in *Wiand v. Lee*, 753 F.3d 1194, 1197 (11th Cir. 2014), the court concluded that because there was no allegation that the Entities' principals "relinquished dominion or control" over the assets, "the Receiver fail[ed] to allege that a FUFTA transfer took place." *Id*. The court further found that "[t]here does not appear to be any set of facts that could support a FUFTA claim against a bank," agreeing with a Florida Eleventh Judicial Circuit Court statement that FUFTA "seems inappropriate as applied to a bank." *Id.* (quoting *Isaiah v. Wells Fargo Bank, N.A.*, Case No. 14-15246-CA-40, at *1 (Fla. 11th Cir. Ct. 2015)).

With respect to the aiding and abetting claims, the court found that the Receiver did not sufficiently allege facts to "allow the fair inference" that JPMC had "actual knowledge of the underlying tort," as required under Florida law to state an aiding and abetting claim. *Id*. at *3. The court therefore dismissed the action with prejudice against JPMC, finding that it could not be held liable based on the routine banking activities of the Ponzi schemers. The Receiver thereafter appealed the district court's decision to the Eleventh Circuit.

Eleventh Circuit's Ruling and Analysis

On June 1, 2020, the Eleventh Circuit affirmed the District Court's dismissal of the Receiver's claims, finding that there was no "transfer" under the FUFTA to support a fraudulent transfer claim. *Isaiah*, 960 F.3d at 1302-03. Moreover, the Receiver did not have standing to bring the aiding and abetting claims against JPMC. *Id*. at 1305. Because the Entities' were tainted by the fraudulent acts of the Ponzi schemers, the Receiver, standing in the shoes of the Entities, could not bring claims against JPMC for aiding and abetting the Entities' own torts. *Id.* at 1306-07.

Fraudulent Transfer Claim: The Court explained that to constitute a "conveyance" or "transfer" of property under the FUFTA, a debtor must "relinquish[] some interest in or control over the asset." *Id.* at 1302. The Eleventh Circuit reaffirmed that "the relevant inquiry is not one of ownership or title but of control." *Id.* at 1303 (citing *In re Levine*, 134 F.3d 1046, 1050 (11th Cir. 1998)). In *Levine*, the court found that a debtor's purchase of an annuity constituted a FUFTA transfer because the debtor could not freely withdraw the funds and had therefore relinquished control. In contrast, the Entities in *Isaiah* merely deposited funds into JPMC account, and JPMC was obligated to return the funds if requested. Because the Entities never relinquished control of the deposited funds, "they did not transfer that money to JPMC within the meaning of FUFTA." *Id.* The Court went on to explain that the often-cited "mere conduit" defense was inapplicable because, as a threshold matter, "Isaiah failed to allege any applicable FUFTA transfer." *Id*. at 1304.

Aiding and Abetting: The court found that the Receiver did not have standing to bring these claims for aiding and abetting breach of fiduciary duty, conversion, and fraud. *Id*. at 1305. The Court explained, "[a]lthough a receivership is typically created to protect the rights of creditors, the receiver is not the class representative for creditors and cannot pursue claims owned directly by the creditors." *Id*. at 1306. Rather, the Receiver "obtains only the rights of action and remedies that were possessed by the person or corporation in receivership." *Id*. In *Isaiah,* because the Entities' "primary existence was as a perpetrator of the Ponzi scheme" the Entities "cannot be said to have suffered injury from the scheme it perpetrated." *Id*. (quoting *O'Halloran v. First Union Nat'l Bank of Fla*., 350 F.3d 1197, 1203 (11th Cir. 2003)). Because the Entities would not have standing to bring the aiding and abetting claims against JPMC, the Receiver similarly could not bring these claims. Rather, the individual investors who suffered injury as a result of the Ponzi scheme—and not the Entities—had standing to bring claims for aiding and abetting torts committed by the Entities. *Id*. at 1307-08.

Practical Implications

With this decision, the Eleventh Circuit curtailed banks' potential liability for fraudulent transfer claims not only in this case, but also for all banks conducting business within the Eleventh Circuit. The Eleventh Circuit now follows the Fourth Circuit's holding that a "transfer" does not occur when the debtor has unrestricted access to his funds in a commercial bank account. *See In re Whitley*, 848 F.3d 205, 210 (4th Cir. 2017). In *Whitley*, the Fourth Circuit held that under bankruptcy section 101(54), which defines a "transfer" in substantially similar terms as FUFTA, "[w]hen the debtor is still free to access [his] funds at will, the requisite 'disposing of' or 'parting with' property has not occurred; there has not been a 'transfer.'" *Id.*

Prior to *Isaiah*, lower courts in the Eleventh Circuit issued contradicting opinions with respect to this issue. For example, in *Furr v. TD Bank, N.A.*, Civ. No. 18-81390-KAM, 2019 WL 4621627, at *2 (S.D. Fla. Sept. 24, 2019), the District Court for the Southern District of Florida affirmed the bankruptcy court's decision that "the Debtors' deposits into their own unrestricted bank accounts maintained at the Defendants' banks do not constitute transfers within the meaning of that term under section 11 U.S.C. § 101(54) or Florida Statute § 726.102(14)." *See also Meridian Tr. Co. v. Batista*, No. 17-23051, 2018 WL 4693533, at *9 (S.D. Fla. Sept. 26, 2018) (granting motion to dismiss FUFTA claim, explaining that "FUFTA seems inappropriate as applied to a bank"); *In re Mongelluzzi*, 591 B.R. 480, 493 (Bankr. M.D. Fla. 2018) (finding that "regular deposits" did not constitute "transfers" under FUFTA); *In re Anderson*, 561 B.R. 230, 242 (Bankr. M.D. Fla. 2016) (finding that transfers between accounts do not constitute fraudulent transfers).

On the other hand, in *In re Palm Beach Fin. Partners, L.P.*, 488 B.R. 758, 769 (Bankr. S.D. Fla. 2013), the Bankruptcy Court in the Southern District of Florida denied a bank's motion to dismiss a FUFTA claim for funds fraudulently received on deposit, finding that the court could not "determine at the motion to dismiss stage whether [the bank was] entitled to the protection" of the "mere conduit" defense. *See also Welch v. Synovus Bank*, 517 B.R. 269, 279-80 n.5 (M.D. Fla. 2014) (denying motion to dismiss FUFTA claim for deposits received by bank); *Clark v. Wilbur*, 211 B.R. 98, 104 (Bankr. M.D. Fla. 1997) (explaining that a "debtor's transfer of funds between his accounts . . . constitutes a transfer as defined by the Bankruptcy Code").

The Eleventh Circuit's clear ruling that ordinary bank transfers and withdrawals into and out of unrestricted depository bank accounts cannot form the basis for fraudulent transfer claims provides strong precedent against claims by future plaintiffs seeking to hold liable banks when their customers engaged in fraud where the banks merely provided ordinary banking services.
