Ponzi Scheme Discovery Boom May Follow in the Wake of Worldwide Economic Contraction: Case Law Update and Key Takeaways for Defending Aiding and Abetting Claims

Article By

Jonathan H. Claydon

Greenberg Traurig, LLP
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Looking back to the Great Recession of 2008 and 2009, the data reflect a sharp
economic downturn has the result of forcing fraudulent schemes into the open. According to [http://www.ponzitracker.com/](http://www.ponzitracker.com/), more than double the number of Ponzi schemes were discovered in 2009 compared to 2008 before the recession began. The number of Ponzi schemes uncovered in 2010, while less than in 2009, was still double the number in 2008.

This trend data indicate that the coming months could see a similar spike in Ponzi scheme discoveries. The spike may inevitably be accompanied by a corresponding uptick in actions by aggrieved investors or receivers seeking to recover funds from financial institutions based on the theory that the fraudster’s conduct was aided and abetted by the provision of banking, investment and transactional services.

In most jurisdictions, the three elements of an aiding and abetting claim are: (1) the existence of an underlying fraud or tort; (2) the defendant’s knowledge of the underlying fraud or tort; and (3) the defendant’s provision of substantial assistance to the scheme’s commission. These cases often turn on application of prongs two and three. As the cases below illustrate, defendant banks often have success defeating these claims aggressively at the motion to dismiss stage where the allegations fail to sufficiently allege anything further than typical banking activity by the defendant. On the other hand, courts have denied motions to dismiss where plaintiffs have alleged specific facts indicating that the financial institution actually knew about the underlying fraud, particularly if the bank’s conduct deviated from standard practice or directly benefitted the bank.

**Isaiah v. JPMorgan Chase Bank, N.A., Case No. 17-15585 (11th Cir. June 1, 2020)**

Factual Summary: The court-appointed receiver for several trading entities asserted claims against Chase for aiding and abetting a Ponzi scheme based on allegations that Chase helped facilitate the Ponzi scheme by transferring funds into, out of, and among the Receivership Entities’ bank accounts, despite its alleged awareness of suspicious banking activity on those accounts. The trading companies had promised significant returns on investments supposedly involving the trade of Venezuelan and U.S. currency, but the investor “distributions” consisted merely of money invested by other duped investors instead of actual gains on legitimate investments. The receiver alleged that Chase had allowed the Ponzi entities to pass millions of dollars through their accounts before shutting down the accounts due to suspicious activity, only to allow the companies to open additional accounts. The receiver asserted that by allowing the Ponzi entities to open additional accounts after closing the initial accounts, Chase assisted the fraudsters by knowingly allowing them to “wind down” the fraud and transfer investor funds.

Legal Holding: The Eleventh Circuit confirmed the lower court’s dismissal of the aiding and abetting claims against Chase on the grounds: (1) the complaint failed to sufficiently allege Chase had knowledge of the underlying fraud; and (2) the receiver lacked standing to bring the aiding and abetting claims because the fraudulent acts perpetrated by the Ponzi entities were imputed to the receiver.

Key Takeaway: The appellate court affirmed the trial court’s dismissal of the aiding and abetting claims for the additional reason that a receiver standing in the shoes of
the tarnished entities that benefitted from the fraud lacks standing to bring such third-party claims because it cannot be said to have suffered an injury from the scheme it perpetrated. The court differentiated these claims from claims brought by a receiver to recover fraudulent transfers, which the court held the receiver had standing to pursue.

**Chang v. Wells Fargo Bank, N.A.,** Case No. 19-cv-01973 (N.D. Cal. April 7, 2020)

Factual Summary: Investors brought suit claiming that Wells Fargo aided and abetted a known Ponzi scheme wherein two fraudsters created a company that promised high returns for investments in pooled real estate funds. The fraudsters improperly commingled investment funds and siphoned large percentages out of the funds for personal use.

Legal Holding: The court denied Wells Fargo’s motion to dismiss the aiding and abetting claims on the grounds plaintiffs sufficiently alleged Wells Fargo had direct and actual knowledge of the fraud based on its anti-money laundering (AML) and Bank Secrecy Act (BSA) monitoring obligations. Plaintiffs alleged that, as part of its AML and BSA duties, the bank reviewed the fraudulent company’s accounts and learned that the fraudsters were commingling and misusing investor funds. The court held that plaintiffs’ allegations of actual knowledge were plausible because they were supported by factual allegations that the bank: (1) reviewed the accounts as part of its “due diligence” obligations; (2) “manually processed” a huge amount of wire transactions that indicated on their face they were from investors; and (3) deviated from its procedures by accepting modified versions of deposit and transfer forms. The court also held that plaintiffs adequately alleged substantial assistance based on these supporting factual allegations.

Key Takeaway: Under California law, the court ruled even “ordinary business transactions” a bank performs for a customer can satisfy the substantial assistance element of an aiding and abetting claim if the bank actually knew those transactions were assisting the customer in committing a specific tort. Given that it was at the motion to dismiss stage, the Court held that it must take the plaintiff’s allegations as true concerning the defendant’s actual knowledge.

**Lucero v. IRA Servs.,** Case No. 18-cv-05395-LB (N.D. Cal. February 3, 2020)

Factual Summary: Plaintiff invested his retirement savings in a self-directed IRA portfolio that promised large returns but turned out to be a Ponzi scheme. Plaintiff sued the fraudsters who ran the scheme, as well as the IRA services companies that acted as custodian and administrator of the account.

Legal Holding: The court granted a motion to dismiss filed by the financial institution defendants on the grounds plaintiff failed to sufficiently allege defendants had actual knowledge of the primary wrong they allegedly assisted. The court held defendants’ knowledge that the investment advisor bought shares of stock at a lower value for his personal account than for plaintiff’s account did not adequately plead that defendants knew that the advisors “were breaching their
fiduciary duty to the plaintiff."

Key Takeaway: The court relied heavily on the California appellate court decision in *Casey vs. U.S. Bank Nat. Assn.*, 127 Cal. App. 4th 1138 (2005), which held plaintiff cannot satisfy the knowledge element of an aiding and abetting claim through an unspecific allegation that a financial institution is aware of wrongdoing generally.


Factual Summary: In an adversary proceeding connected to the bankruptcy of the entity that managed individual pieces of real estate, the bankruptcy trustee alleged that TD Bank assisted in a fraud scheme whereby the management entity’s executive: (1) knew that many of the real estate properties were not cash flow positive; (2) began commingling funds among the numerous investment parcels; and (3) subsidized disbursements from non-performing investments with revenue from performing investments. The trustee alleged that TD Bank aided and abetted the years-long fraud because it was aware the individual investments were supposed to be “siloed” but funds were regularly transferred between the accounts of the many debtor entities and most often into the account of a debtor who had an urgent use for funds.

Legal Holding: The court held the trustee had not sufficiently alleged TD Bank’s knowledge of the fraud scheme because “the bank had no duty to monitor its customer’s depositary accounts” and “[s]imply knowing that the investments were to be siloed is not enough to show reckless[] indifference.” The court further held the trustee failed to allege substantial assistance because TD Bank’s alleged conduct, i.e., allowing bank transactions and transfers, was “mere inaction” or “continued participation in a transaction,” which is insufficient to show substantial assistance under Connecticut law.

Key Takeaway: Under Connecticut law, the standard required to show knowledge of the fraud is binary. Plaintiff must plead facts showing defendant had “actual knowledge of the underlying tort” or defendant acted with “reckless indifference to the possibility that the underlying tort is occurring.” The court defined reckless indifference as “something more than a failure to exercise a reasonable degree of watchfulness to avoid danger to others or to take reasonable precautions to avoid injury to them.”


Factual Summary: 600 investor plaintiffs sued numerous banks asserting they had aided and abetted a fraudulent investment brokerage scheme in which numerous brokers funded their lavish lifestyle with investor funds. Plaintiffs further alleged a bank branch manager had a relationship with one of the brokers and assisted in the scheme by coordinating the opening of accounts, expediting the availability of funds, and lying to creditors.
Legal Holding: The court ruled plaintiffs failed to allege actual knowledge of the scheme because: (1) there were no facts alleged showing that the banks knew that their branch manager was involved; (2) a bank’s merely negligent failure to identify red flags and warning signs of fraudulent activity are not sufficient to impute knowledge of fraud; (3) the allegations did not even show that the branch manager had actual knowledge of fraud as opposed to simply atypical business transactions; and (4) there were no facts alleged that the banks were aware of the offering materials reflecting the existence of a fiduciary duty. The court also ruled plaintiffs failed to allege that the banks substantially assisted the scheme because there was nothing more than the provision of “banking services.”

Key Takeaway: The court relied heavily on the Second Circuit’s statement “banks do not owe non-customers a duty to protect them from the intentional torts of their customers.” Lerner v. Fleet Bank, N.A., 459 F.3d 273, 286-87 (2d Cir. 2006).

**Evans v. ZB, N.A., Case No. 18-15094 (9th Cir. June 24, 2019)**

Factual Summary: Plaintiffs brought a class action complaint alleging that the bank’s customer, “IMG,” orchestrated a $100 million Ponzi-scheme in which it misrepresented to investors it had lucrative contracts to provide latex gloves to government agencies, but instead stole loan funds and used later investor monies to pay earlier investors. Plaintiffs further alleged the bank had knowledge the enterprise was a sham because it issued millions of dollars in loans to IMG and stopped loaning money after it learned that the company had little or no earnings from its claimed business.

Legal Holding: The Ninth Circuit reversed the district court’s dismissal of the aiding and abetting claims on the grounds plaintiffs’ allegations the bank knew the sham nature of the business were plausible since the bank: (1) required IMG to pay all funds into a “lock-box” account after IMG failed to make timely payments on a credit line; (2) maintained the lock-box account and monitored the deposits therein after it extended the maturity of the credit line; (3) had actual knowledge that IMG had no revenue from the sale of latex gloves; and (4) departed from standard industry practices by making advances without supporting documentation or proper verification. The court held the allegations plausibly alleged the bank knowingly assisted IMG to facilitate IMG’s continued solicitation of cash investments because the bank knew those funds were needed to repay the bank loans in the absence of legitimate revenue.

Key Takeaway: One judge filed a dissent arguing the dismissal should be affirmed because banks have no duty to supervise activity in customer accounts. But the majority rejected that notion stating “the question isn’t whether [the bank] had a duty to supervise the account—the question is whether Plaintiffs allege that [the bank] actually did monitor the account.”

**Vasquez v. HSBC Bank, USA, N.A., Case No. 18 Civ. 1876 (S.D.N.Y. May 30, 2019)**

Factual Summary: Plaintiffs asserted that HSBC assisted a Ponzi scheme in which investors were fraudulently induced to wire funds to HSBC USA accounts for
investing in the cloud computing space. The investment turned out to be a classic pyramid scheme, and plaintiffs alleged HSBC learned of this fact in September 2013 but allowed the perpetrators to conduct transactions and transfer funds until March 2014. Plaintiffs claim that HSBC USA aided and abetted the Ponzi scheme because it had actual knowledge of fraudulent activity since it “flagged” one or more wire transfers sent in July 2013 and began an investigation into the Ponzi scheme entity.

Legal Holding: The court ruled that, in accepting the allegations as true as it was required to do that motion to dismiss stage, the plaintiff had adequately that HSBC USA “consciously avoided” knowledge of the fraud. The court defined conscious avoidance as “awareness of a probability of fraud and a decision to refrain from confirming that fact.” The court ruled that Plaintiff’s allegation that HSBC USA investigated a flagged wire meant that HSBC USA purportedly followed up its suspicions of fraud with an investigation that revealed the fraudulent nature of the customer’s scheme. Nevertheless, the court dismissed the aiding and abetting claims because plaintiff failed to allege the element of substantial assistance. The court held that maintaining a correspondent account for the fraudster’s Hong Kong accounts was merely inaction that did not rise to the level of substantial assistance, particularly where it was not adequately pled to be the proximate cause of the alleged fraud.

Key Takeaway: While the court found the allegations sufficiently to show “conscious avoidance” so as to satisfy the actual knowledge element of an aiding and abetting claim, the decision emphasized this standard was higher than a typical “constructive knowledge” standard. Conscious avoidance “involves a culpable state of mind whereas constructive knowledge imputes a state of mind on a theory of negligence.”

Zhao v. JPMorgan Chase & Co., Case No. 17 CV 8570 (S.D.N.Y. March 13, 2019)

Factual Summary: Plaintiffs invested millions of dollars in a company that sold investments in restaurants and bars converted into work spaces for lease by professionals. The company raised more than $36 million, all of which was deposited into an account at Chase. The lone executive of the investment company absconded to Morocco with the funds and was later arrested. Plaintiffs allege Chase aided and abetted the fraudulent scheme by failing to properly vet the executive and his company when he opened the accounts at Chase and by knowingly providing banking services to a criminal enterprise.

Legal Holding: The court dismissed the claim for aiding and abetting a breach of fiduciary duty on the grounds that: (i) plaintiffs failed to allege the existence of a fiduciary duty owed to plaintiffs by the investment company; (2) plaintiffs failed to allege any facts showing Chase had actual knowledge of a fiduciary relationship between plaintiffs and the investment company; (3) plaintiffs failed to allege that Chase had any knowledge of any breach or misconduct by the investment company. The court found, at most, Chase had access to the marketing materials given to the investors and had knowledge of banking transactions (frequent wire transfers, including to accounts in foreign countries), which the court found to fall short of alleging actual knowledge. The court also held the complaint failed to allege substantial assistance by Chase because: (1) inaction of an alleged aider and
abettor constitutes substantial assistance only if the primary wrongdoer owes a fiduciary duty directly to plaintiff; and (2) the single affirmative action alleged—Chase declining a wire transfer recall request—was not an “atypical” or “non-routine” transaction.

Key Takeaway: The court cited approvingly an earlier Southern District of New York decision, Nigerian Nat’l Petroleum Corp. v. Citibank, N.A., No. 98 Civ. 4960, 1999 WL 558141, at *7-8 (S.D.N.Y. July 30, 1999), which held there were insufficient allegations to establish a “strong inference of actual knowledge of fraud” where it was alleged the bank knowingly disregarded several indications of fraud, including fund transfers from a company account to a personal account.


Factual Summary: Plaintiffs alleged that numerous banks provided banking services to TelexFree, which was found to be running a pyramid scheme that negatively impacted over a million investors. Plaintiffs (in numerous consolidated actions) asserted that the banks ignored red flags and allowed TelexFree to make funds transfers to personal accounts of the founders, foreign entities and shell companies.

Legal Holding: The court granted defendants’ motions to dismiss on the grounds that: (1) the provision of routine banking services was merely passive activity that was insufficient to establish substantial assistance; and (2) alleging that the banks had access to TelexFree’s promotional materials, which should have alerted the banks that the TelexFree investment was fraudulent, was insufficient to plead actual knowledge.

Key Takeaway: The court was unequivocal, under Massachusetts law, “the fact that a bank should have recognized a fraud does not mean that it had actual knowledge of fraud.”


Factual Summary: Scammers ran a lengthy Ponzi scheme that took in almost $200 million from investors who believed their funds were being invested in foreign currency indexes. A court-appointed receiver sued Associated Bank for aiding and abetting the scheme based on allegations a bank employee opened accounts for the fraudulent entities and serviced those accounts for the life of the scheme.

Legal Holding: The Eighth Circuit affirmed the grant of summary judgment for the bank on the grounds: (1) there was no direct evidence that the bank employee or anyone else at Associated Bank had either actual or constructive knowledge of the scheme; and (2) there was no evidence of substantial assistance by the bank, only the “provision of routine banking services.”

Key Takeaway: Under Minnesota law, plaintiff can establish the knowledge element of aiding and abetting by showing the defendant had “constructive knowledge” of the fraud, but to do so it must show the “primary tortfeasor’s conduct is clearly tortious
or illegal.”

**Conclusion:**

For financial institutions, the question now is not if you will be sued in connection with a Ponzi scheme; the question is when you will be sued and how often. As these authorities demonstrate, the key distinction between winning and losing an aiding and abetting claim is the depth and scope of the bank’s knowledge of the conduct underlying the alleged fraud. Especially now, when customer activity may be altered by economic upheaval and customers may be seeking assistance in restructuring and/or reorganizing their debt obligations, it is important that customer-facing staff: (1) be aware of the risk of fraud; and (2) be reminded of the indicators of fraud and the importance of reporting and escalating any suspicious conduct/transactions.

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