In the Supreme Court
State Of North Dakota

July 6, 2015

Supreme Court No. 20150008

PHI Financial Services, Inc.,

Plaintiff, Appellee and Cross-Appellant,

v.

Johnston Law Office, P.C.,

Defendant, Appellant, and Cross-Appellee

Choice Financial Group,

Defendant, Appellee and Cross-Appellant.

Supreme Court No. 20150008

Grand Forks County Number: 18-2012-CV-00577

APPEAL FROM FINAL JUDGMENT
THE DISTRICT COURT OF GRAND FORKS, NORTH DAKOTA
NORTHEAST CENTRAL JUDICIAL DISTRICT
THE HONORABLE THOMAS E. MERRICK, PRESIDING

REPLY BRIEF OF DEFENDANT, APPELLANT, AND CROSS-APPELLEE
JOHNSTON LAW OFFICE, P.C.

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[1] TABLE OF AUTHORITIES

I. North Dakota's use of the term *"first transferee"* in N.D.C.C. § 13-02.1-08(2), instead of the term *"initial transferee"* as used in 11 U.S.C. § 550, does not prevent Johnston Law from establishing its defense to liability.

[2] North Dakota statutory law provides that a party must be a *"first transferee"* in order to be liable for a fraudulent transfer. Although there is no North Dakota case law which defines a "first transferee", Johnston Law in its initial brief provided federal case law defining an "initial transferee" under the corresponding federal statutory law of 11 U.S.C. § 550.

[3] PHI Financial Services ("PHI") argues the North Dakota statute lacks the term *"initial transferee"*, voiding federal case law analysis addressing "initial transferees" under 11 U.S.C. § 550, and as such N.D.C.C. § 13-02.1-08(2) does not provide Johnston Law Office ("Johnston Law") a defense.

[4] PHI's argument is frivolous because: (1) the language in both North Dakota and the corresponding Federal statutes are virtually identical; (2) the North Dakota statute has been largely derived from its federal counterpart; and (3) PHI can point to no legal authority – *statutory or decisional* – to support PHI's proposition that the slight difference in language between the terms *"initial transferee"* and *first transferee"* operates to deny to Johnston Law protection from liability to PHI.

[5] Johnston Law maintains that the North Dakota statute should be construed by the Supreme Court in a manner similar to the federal courts' interpretation of 11 U.S.C. § 550 because the North Dakota statute derives from the federal statute. Significantly, N.D.C.C. § 13-02.1-08 is part of the Uniform Fraudulent Transfer Act ("UFTA"), and the UFTA derives in principal part from Section 550 of the bankruptcy code, 11 U.S.C. § 550. *See, e.g., Stuart v. Comm'r*, 2015 U.S. Tax Ct. LEXIS 14, *56 (T.C. Apr. 1, 2015);

Renda v. Nevarez, 223 Cal. App. 4th 1231, 1236 (Cal. App. 4th Dist. 2014); and *General Elec. Capital Auto Lease v. Broach (In re Lucas Dallas, Inc.)*, 185 B.R. 801 (B.A.P. 9th Cir. Cal. 1995).

[6] Consistent with its origin, the language of N.D.C.C. § 13-02.1-08(2) and 11 U.S.C. § 550 of the bankruptcy code are very similar. N.D.C.C. § 13-02.1-08(2) states: "judgment may be entered against the first transferee". Bankruptcy Code Section 550 provides that, "the trustee may recover from….. the initial transferee …". The only difference being the use of *first transferee"* in the federal statute and *"initial transferee"*, in 13-02.1-08(2). There is nothing in the language or legislative history of N.D.C.C. § 13-02.1-08(2) to support PHI's flawed proposition that the North Dakota legislature intended to revoke the protection provided to conduits of transfers as provided in 11 USC 550.

[7] Because North Dakota's version of the UFTA unquestionably derives from 11 U.S.C. § 550, the Supreme Court should consider decisions of the federal courts which have interpreted and construed 11 U.S.C. § 550 to be strong persuasive authority as the Supreme Court interprets and construes N.D.C.C. § 13-02.1-08(2). See, e.g *City of Grand Forks v. Ramstad*, 2003 ND 41, P17, 658 N.W.2d 731, 736 (N.D. 2003). A mere conduit is not liable for a transfer under 11 U.S.C. § 550. *Leonard v. First Commerce. Mortgage Co. (In re Circuit Alliance, Inc.)*, 228 B.R. 225, 232 (Bankr. 1998).

[8] Therefore, because N.D.C.C. § 13-02.1-08 derives from 11 U.S.C. § 550 and federal decisional authorities are virtually uniform in holding that a mere conduit may not

be held liable under the UFTA, it is respectfully submitted that Johnston Law cannot be liable to PHI for G&K's transfer Merlyn Grabanski.[1]

II. The District Court's finding of fact that Johnston Law provided G&K Farms with reasonably equivalent value for the transfer is not clearly erroneous and as such may not be disturbed in the instant appeal.

[9] The District Court made the express finding of fact that Johnston Law had provided G&K Farms with reasonably equivalent value for its transfer of $145,774.63 to Johnston Law. (Doc. 403). In the instant appeal, PHI argues that the District Court's finding of fact in this regard was simply wrong while serving up the same arguments in this appellate setting as it had presented unsuccessfully to the District Court in the first instance. Nothing in the District Court's decision that Johnston Law had provided reasonably equivalent value to G&K Farms was "clearly erroneous".

[10] This Court has emphasized the well-established standard that, "(a) finding is clearly erroneous under Rule 52(a) only if it is induced by an erroneous view of the law, if there is no evidence to support it, or if, although there is some evidence to support it, on the entire evidence, the appellate court is left with a definite and firm conviction that a mistake has been made.." *McDonough v. Murphy*, 539 N.W.2d 313, 316 (N.D. 1995). PHI argues that the District Court's finding should be overturned on the basis that

[1] PHI claims that even if N.D.C.C. § 13-02.1-08 does provide a defense for a mere conduit, that Johnston Law cannot avail itself of the "mere conduit defense" under this statute, purportedly because Johnston Law did not obtain the transfer in good faith and should have known that the transfer might be voidable. Firstly, PHI provides no citation of statutory or decisional authority to support of its assertion that "good faith" and "without knowledge of possible voidability of the transfer" are indispensable requisite elements of the "mere conduit" defense, and Johnston Law could find no statutory or decisional law which would stand in support of this unsupported argument by PHI. Nevertheless, the District Court did find that Johnston Law was a good faith transferee and that Johnston Law believed the transfer to be not voidable. Therefore, Johnston Law would not be liable to PHI for the transfer to Merlyn Grabanski -- even if "good faith" and "without knowledge of possible voidability of the transfer" *were* requirements for one to be protected by the "mere conduit" defense.

the Supreme Court must come to the "definite and firm conviction" that "a mistake has been made." *Id.*

[11] PHI argues that Johnston Law could not have provided any value because G&K Farms received actual value of $35,000, G&K Farms was abandoned prior to Johnston Law's involvement, and Johnston Law had a conflict of interest in bankruptcy litigation, none of which preempt or preclude the District Court from making its finding of "reasonably equivalent value".

[12] That Johnston Law provided $35,000 in value to G&K Farms does not prevent Johnston Law from providing ***reasonably equivalent value for the transfer***. Reasonably equivalent value requires evaluation of the entire circumstances surrounding the transaction. *Charys Liquidating Trust v. McMahan Sec. Co., L.P.* (In re Charys Holding Co.), 443 B.R. 628, 637 (Bankr. D. Del. 2010). The District Court considered the related interest of the entities in determining whether reasonably equivalent value was provided. (Doc 403). The Court assigned $35,000 directly to G&K itself and found as fact that Johnston Law provided an *indirect benefit* to G& K Farms through Johnston Law's legal services to related entities.

[13] The record debunks PHI's allegations that the partnership allegedly had been abandoned. G&K Farms the operation was ***never abandoned*** but later called Texas Family Farms. (Doc 403; T. 149 Ln21-22; APP-206). Regardless of the operational status, the factual finding of "reasonably equivalent value" due to the shared interest of the entities and *indirect benefit* from all of Johnston Law's legal services provided to the Grabanskis cannot be disturbed.

[14] The legal reality of a partnership does not change when its operation continues with nothing more than a name change or change in partners as noted in the instruction to federal tax form 1065

Item G

> A technical termination (box G(6)) occurs when there has been a sale or exchange of 50% or more of the interests in partnership capital and profits within a 12-month period. If this Form 1065 is being filed for the tax period ending on the date a technical termination has occurred, check box G(2) and box G(6) … A new EIN is not needed in a technical termination. The new partnership that is formed will continue to use the EIN of the terminated partnership.

Any alleged conflict of interest regarding the entities is just another PHI red herring.

III. A good faith transferee which provides reasonably equivalent value is offered an absolute defense to liability for a fraudulent transfer.

[15] N.D.C.C. § 13-02.1-08 provides a complete defense to a good faith transferee who provides reasonably equivalent value for a transfer. PHI alleges that the defense only applies to fraudulent transfers brought pursuant to Section 13-02.1-04(1)(a), the basis for the District Court's finding of fraudulent transfer. (Doc 403). PHI argues that because Johnston Law could also be liable pursuant to Section 13-02.1-04(1)(b) or Section 13-02.1-05, that Johnston Law can be found liable despite having provided reasonably equivalent value.

[16] Disregarding the fact that the District Court found the transfer voidable only under Section 13-02.1-04(1)(a), PHI's argument fails because a transfer for reasonably equivalent value is protected under all three sections. A transfer is voidable under Section 13-02.1-4(1)(a) if a party acted with actual intent to hinder a creditor. Because "reasonably equivalent value" is not a factor which is considered when voiding a transfer

pursuant to Section 13-02.1-4(1)(a), it is therefore provided as a defense under Section 13-02.1-08.

[17] Reasonably equivalent value is not a defense for Section 13-02.1-04(1)(b) and 13-02.1-05 because it is a required element to void a transfer. To be voided under those two sections, the transfer ***must not*** have been made for reasonably equivalent value. The transfer to Johnston Law cannot be voided under Section 13-02.1-04(1)(b) and 13-02.1-05 because Johnston Law provided reasonably equivalent value. Reduced to the essentials, Johnston Law is free from lability because Johnston Law provided reasonably equivalent value for the transfer.

IV. Choice Financial Bank Failed to bring its Claim under the Jurisdiction of this Court.

[18] The law of the land indicates that any claim Choice Bank may assert—regardless of the fact that Choice Bank has failed to bring a colorful issue in its notice of cross-appeal and subsequent briefing—is barred from doing so under the auspice of an unfavorable interlocutory pretrial ruling.

> … May a party, as the Sixth Circuit believed, appeal an order denying summary judgment after a full trial on the merits? ***Our answer is no***. …

Ortiz v. Jordan, 562 U.S. 180, 183-184, (U.S. 2011) (emphasis added).

[19] The Eight Circuit has similarly held:

> … We will not review a district court's denial of a motion for summary judgment after a trial on the merits. *See Eaddy v. Yancey*, 317 F.3d 914, 916 (8th Cir.2003) … Therefore, because the parties had a full trial on the merits, we will not review the district court's decision to deny AT & T's motion for summary judgment.

E.E.O.C. v. Sw. Bell Tel., L.P., 550 F.3d 704, 708 (8th Cir. 2008). Choice Bank chose not to participate in the trial and failed to preserve an argument.

[20] This Court with extensive citation to *Moore v. Am. Family Mut. Ins. Co.*, 576 F.3d 781, 784 (8th Cir. 2009) adopted the circuit holding that to preserve issues of law after trial a motion for judgment as a matter of law must precede appellate review:

> … Eighth Circuit Court of Appeals concluded American Family had failed to preserve for review the contention that it was entitled to judgment as a matter of law on the Moores' bad faith claim …

Minto Grain, LLC v. Tibert, 2009 ND 213, ¶ 28, 776 N.W.2d 549, 559 (ND 2009).

[21] Finally, because Choice Bank did not file a timely notice of appeal from the summary judgment order from which it complains and did not appear at the trial the time for review is long past. *Ortiz v. Jordan*, 562 U.S. 180, 188-189. Therefore, Choice Bank's Cross-Appeal should be dismissed or in the alternative deemed jurisdictionally deficient and ignored.

CONCLUSION

[22] Both parties Cross-Appeals should be deemed without merit.

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CERTIFICATE OF ELECTRONIC SERVICE

I, **DeWayne Johnston**, attorney for the Defendant\Appellant, and officer of the court, hereby certify that a true and correct copy of the foregoing:

1. **Corrected Reply Brief of Appellant, and Cross-Appellee Johnston Law Office;**

were served via **ELECTRONIC MAIL** from Grand Forks, North Dakota on this 13h day of July, 2015 to:

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Dated this 13th day of July, 2015.

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