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Federal Court To Decide Whether GE Capital Was Complicit In Ponzi Scheme

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By December 8, 2000, GE Capital Corporation (GECC) had received nearly $50 million that it had loaned to Petters Capital, a company that specialized in buying bulk lots of merchandise from various retailers and then re-selling them to large, big box, distributors like Costco and Walmart. GECC had grown concerned over Petters' banking habits, late payments, unscrupulous owner and the discovery that the underlying assets were fraudulent. Getting the money returned must have been a huge relief.

GECC grew suspicious enough to place a call directly to Costco, one of the vendors reported on Petters Capital's receivables. Costco had no record of the invoices that Petters had reported to GECC as outstanding. Paul Feehan, an executive of GECC at the time, got on the phone and started screaming at Petters, according to a deposition given in October 2013, "This is a fraud. This is all one, big fraud." When things calmed down, Petters promised to pay back the loan along with all the substantial fees associated with it. After a few missed promises-to-pay, the final payment occurred and GECC went on its way to find new customers and Petters' CEO, Thomas Petters, went on to continue building one of the largest Ponzi schemes in U.S. History.

In April 2010, Petters was sentenced to 50 years in prison after being convicted of fraud by a jury in federal court. The result was that investors lost over $2 billion, with the largest being a small investment firm in South Florida, Palm Beach Financial Partners (PBFP).

In late 2002, PBFP loaned Petters Capital, $10 million to finance his new 'big box' venture, Petters Group, and the loans were promptly paid back with interest. PBFP wanted to loan more and Petters offered them great returns through financing his growing business. Over the following six years, PBFP would finance nearly 2,500

separate promissory notes with a value of $8.7 billion in principal. Then, on September 24, 2008, Petters Group Worldwide headquarters in Minnetonka, MN was raided by federal agents who had information to believe that Petters was running a Ponzi scheme. For PBFP, it meant that their entire investment was lost.

PBFP and another fund that was spun off by it, Palm Beach Finance II, went into bankruptcy and Barry Mukamal was appointed as Chapter 11 Trustee for the funds. To date, Mukamal and his team have recovered $65 million from litigation and $35 million from Peters Company bankruptcy estate. Now he has his sights on GECC.

In Mukamal's view, PBFP would have never loaned Petters a dollar if the fraud that GECC had discovered back in 2000 had been disclosed. According to a financial expert hired by Mukamal, not only did GECC not report Petters' earlier defaults to its auditor, Ernst & Young, but it failed to comply with Bank Secrecy Act and Anti-Money Laundering regulations for not filing a Suspicious Activity Report with regulators or law enforcement. According to Solomon Genet, who provides litigation oversight counsel for Mukamal, "GE Capital discovered and assisted the third-largest financial fraud in U.S. history. We look forward to presenting GE Capital's wrongdoing to a jury."

Mukamal and his team have been resilient. Mukamal even went as far as to visit Petters in Leavenworth Federal Prison and was rewarded with a written declaration (worth a read) that spoke to his relationship with GECC in the final days of their financial relationship. When GE Capital representatives showed up for a formal deposition, Petters (59 years old) refused to talk. Petters is scheduled to be released in April 25, 2052, he will be 94 years old.

This month, U.S. District Bankruptcy Judge Paul G. Hyman, Jr. ruled that he would neither give summary judgement for GECC to dismiss the lawsuit, nor grant PBFB an outright judgement for damages from GECC. So on to trial they go.

GECC's position is interesting in that it does not dwell on the coverup of the original Petters loan, but on a position that only the Petters trustee, not PBFB's, has standing to hold GECC liable. Judge Hyman summarized GECC's position as, "GECC cites several recently-decided cases which appear to stand for the proposition that a creditor of a bankrupt entity lacks individual standing to sue a third party for a generalized injury that is common to all creditors." However, Judge Hyman did not

agree saying that such a position" … misconstrue a bankruptcy trustee's role and fail to address the lack of statutory authority permitting a bankruptcy trustee to bring a cause of action on behalf of a debtor's creditors."

According to Jeffrey Sloman, the former United States Attorney for the Southern District of Florida and now a private attorney who was called on as an expert by Mukamal, it looks like GECC would have faced criminal charges had he been at the helm and known about the Petters discovery. Sloman concluded, "… had I been presented with these facts while I was a prosecutor, I would have concluded that there is probable cause that GECC's employees committed promotional money laundering and conspiracy to commit promotional money laundering, and that GECC could be held criminally liable for the illegal acts of its employees, and therefore, I would likely have sought an indictment." Sloman knows a good Ponzi scheme when he sees one, he worked on the Scott Rothstein case in South Florida.

Regulators have come under scrutiny for not detecting frauds such as those committed by Bernie Madoff and Art Nadel. However, regulators depend on the watchful eyes of those in the business community to speak up when they see something is wrong. In this case, it may not have been the regulators who failed us as much as one of our own financial institutions who thought more of covering their assets than about speaking up.

GECC has not given up on avoiding a trial. They filed a number of motions after this most recent ruling.

It looks like we know what happened, but the remaining question is, "Who should pay for it?"

When Walt is not writing on white collar crime, he works with experts who present on it. Check out 500 Pearl Street Speakers or contact him at walt.pavlo@500pearlstreet.com.

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