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Kelley v. BMO: Did the Eighth Circuit Get It Wrong?

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By Daniel J. McGarry

Stop me if you have heard this one before: "A receiver walks into bankruptcy court." This happened recently in Minnesota, and it did not end well for the court-appointed receiver. In Kelley v. BMO,1 the Eighth Circuit Court of Appeals reversed the largest jury verdict ever awarded in Minnesota, which had been entered against BMO Harris Bank for $563.7 million. With prejudgment interest, this figure had been expected to top $1 billion.

However, in a surprise reversal — and what will likely mark the final chapter in the decade-long saga involving Tom Petters and the Ponzi scheme he engineered — a three-judge panel led by the Eighth Circuit's chief judge ruled that whatever protections may have been afforded a receiver to the defense of in pari delicto in Minnesota state court, those protections did not follow him into bankruptcy court. Rather, the equitable defense of in pari delicto was an absolute shield to the claims brought by the trustee in bankruptcy against BMO.

In essence, the Eighth Circuit ruled that the case against BMO should never have survived the pleading stage. The U.S. Supreme Court subsequently denied cert, and the case against BMO is now over. Did the Eighth Circuit get it wrong? Did the filing of a receivership in Minnesota state court in any way "transmute" the claims, defenses or parties before entering bankruptcy such as to give the receiver a clear path forward? Was the pre-petition receivership filing simply a meaningless act? Did the Eighth Circuit give BMO a "free" pass?

The Petters Ponzi Scheme

Tom Petters ran a highly lucrative and very successful Ponzi scheme2 in Minnesota for many years, but it collapsed in 2008. He eventually pleaded guilty to various fraud-related crimes and was sentenced to decades in federal prison. His company, Petters Co. Inc. (PCI), was placed into the hands of federal receiver Doug Kelley. Five days after his appointment, Kelley put PCI into bankruptcy and was named the trustee. Kelley eventually commenced an adversary

proceeding against BMO that had banked PCI for years3 for (among other things) aiding and abetting PCI's fraud against the company's investors.

As it would continue to do throughout the litigation, BMO raised the equitable defense of in pari delicto, which "embodies the principle that a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing."4 The bankruptcy court and Minnesota district court (in denying a request from BMO for an interlocutory appeal on the issue) refused to allow the bank to assert the defense, finding that under applicable Minnesota law, Kelley's appointment as a pre-petition receiver had "cleansed" PCI of any taint from Petters's Ponzi scheme, thus freeing Kelley (now acting as bankruptcy trustee) to pursue these claims unfettered by the in pari delicto defense in bankruptcy. After the close of evidence, BMO again asserted in pari delicto as a defense in post-trial motions, which again was denied. BMO appealed.

At the Eighth Circuit, a three-judge panel unanimously reversed, holding that PCI's pre-petition trip through receivership was not enough to relieve the bankruptcy estate from having to contend with the in pari delicto defense. While Kelley as receiver would have been able to pursue such claims in Minnesota state court free from the constraints of the in pari delicto defense, the panel concluded that protection from this defense went away once the receiver "walked" into bankruptcy court.

The panel started with the proposition that outside of bankruptcy, Minnesota law dictated what rights and powers the receiver had. It found that Minnesota law was quite clear that appointment of a receiver changed the management of PCI. Kelley agreed, arguing that once the managers who facilitated the Ponzi scheme were removed from PCI, the "sting" of the wrongdoing was removed as well. However, the panel went on, upon entering bankruptcy, Kelly took off his receiver hat and put on his trustee hat. At that point, any claims that Kelley had against BMO were subject to the dictates of § 541, which states that claims come into bankruptcy with their defenses intact. According to the Eighth Circuit, this meant that Kelley as trustee was subject to the in pari delicto defense. Under the circumstances, this was an absolute bar to his claims as trustee.

The panel summarily reversed the judgment that had been entered against BMO without so much as allowing a remand to the lower court to determine whether the equities dictated any relief for Kelley. In essence, the Eighth Circuit viewed in pari delicto not as an equitable affirmative defense, but rather as a standing issue.5 Kelley's subsequent request for a

rehearing and rehearing en banc to the Eighth Circuit was denied without comment,6 as was Kelley's cert petition to the Supreme Court.7

In arriving at its decision, the Eighth Circuit disregarded most of BMO's arguments and focused instead on Kelley's decision to pursue the claims in bankruptcy, which the panel concluded was doomed from the outset. Specifically, it found that Kelley's appointment as a receiver did not change receivership entity PCI, only its "management." "PCI's management changed again when Kelley as receiver filed for bankruptcy on behalf of the entity."8 Kelley had similarly argued that once bad management was out, any recovery inured to the benefit of the innocent victims. Thus, according to Kelley, in pari delicto was no longer a viable defense.

Removal of the "bad actors" always occurs in a bankruptcy liquidation, because the "bad" management is replaced by an "untainted" trustee. By this reasoning, in pari delicto could never be successfully raised in bankruptcy because bad management is almost always removed upon the filing of a liquidating bankruptcy. This was a possible slippery slope that the panel could have foreseen had it followed Kelley's argument to its logical conclusion, though the panel did not expressly state this.

Another major point of contention raised by Kelley on appeal was whether the Minnesota Supreme Court should be given an opportunity to issue an "advisory opinion"9 explicating Minnesota state law receivership principles in the context of bankruptcy. "Too late," was BMO's refrain. Just because Kelley received an unfavorable decision from the Eighth Circuit on an issue of Minnesota state law, that did not entitle him to a second bite at that apple.

Kelley the Receiver vs. Kelley the Trustee

While much of the cert discussion revolved around the issue of whether the Eighth Circuit should have certified the controlling question of Minnesota law to that state's highest court, it is not at all certain that an advisory opinion from Minnesota's highest court would have swayed the panel, because Minnesota law was never really at issue. The analogy of the receiver "switching hats" in this context is therefore inapt.

A better analogy is that when Kelley entered bankruptcy court, he was entering an entirely different game, played under entirely different rules. Whatever happened pre-petition was irrelevant. Once he "stepped into the shoes of the debtor" and became the bankruptcy court trustee, it was as if the receivership had never happened. At oral argument, the panel quickly dismissed the pre-petition receivership assignment, suggesting that this would appear to be

little more than an easy way to side-step the in pari delicto defense with a short, "cleansing" trip through a state court receivership proceeding. After all, Kelley was a receiver for less than a week in a case that would eventually stretch on for years.

A more accurate way to view this dichotomy between Kelley as receiver vs. Kelley as trustee, then, is not through the claims that Kelley could assert, but rather through the parties on whose behalf those claims were being asserted.10 Kelley as receiver was prosecuting the claims of the "innocent" victims of PCI, against which in pari delicto was not a viable defense. However, Kelley as trustee in bankruptcy was asserting the claims of PCI itself, and PCI was decidedly not innocent.

After all, as BMO repeatedly pointed out, PCI was set up specifically to facilitate the Ponzi scheme. The company had, at the receiver's direction, pleaded guilty to fraud and several other significant crimes. When viewed in this light, it is easy to see how the panel might have been unpersuaded by Minnesota's view on receivership law, because it meant very little in the context of a bankruptcy filing. Thus, Kelley's request for an advisory opinion was somewhat beside the point. As the panel plainly stated, "PCI is the debtor; the receiver is not involved in the bankruptcy proceeding."11

In addressing the issue of Minnesota law, the panel stated baldly that "[n]o Minnesota decision purports to eliminate the defense of in pari delicto in a bankruptcy case."12 This statement is true, Kelley said, but only to a point: (1) Minnesota state law eliminated the defense pre-petition when it decided that receivers are immune from in pari delicto, which was subsequently confirmed by two separate lower court judges in this very case; and (2) if there is any doubt about how Minnesota views the in pari delicto defense in this context, then an advisory opinion is warranted.

Kelley was never given a chance to return to Minnesota to petition for that advisory opinion. The briefing betrays a mounting frustration at the apparent trick box13 that Kelley perhaps believed the panel had placed him in, or a trick box of Kelley's own creation from which the panel would not let him escape — this trick box being what Minnesota law has to say about the in pari delicto defense in bankruptcy. The outcome of that inquiry would have carried very little weight with the panel for the reasons explained.

Was the Outcome the Right One?

This was a harsh outcome, but was the Eighth Circuit's decision correct, both practically and prudentially? To permit a "bad actor" such as PCI to recover a billion-dollar judgment against one of its alleged co-conspirators14 in bankruptcy court would have been highly problematic. Although Kelley tried to press the equities of the case, the panel was not swayed.15 Moreover, an advisory opinion from the Minnesota Supreme Court that was viewed as either invading the province of the bankruptcy court and its determination of what constitutes the debtor's estate, or what may have been interpreted as an attempt to recharacterize or insulate claims from defenses post-petition, would have been collaterally attacked in bankruptcy court and more than likely preempted.

Another way to look at this appeal is that by treating in pari delicto as a standing issue, rather than an equitable defense, the Eighth Circuit got it wrong.16 No "balancing" occurred. Rather, the panel treated in pari delicto as an absolute bar, thus cutting off a significant potential source of recovery for Petters's victims.

Other courts, applying a balancing approach, would likely have given Kelley at least the opportunity to make such an argument on remand. As one bankruptcy court stated when refusing to apply the in pari delicto defense in the context of corporate malfeasance, it is simply not "equitable for negligent third parties to enjoy a windfall by gaining absolution from liability for their negligence while innocent creditors bear the loss."17 After years of litigation and appeals, the creditors of Petters's Ponzi scheme were left with nothing, and that is no joke at all.

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- 1 Kelley v. BMO Harris Bank Nat'l Ass'n (Kelley), 115 F.4th 901 (8th Cir. 2024).
- 2 Petters's "business" was to purchase overstocked electronics from overseas wholesalers and resell them (presumably at a markup) to domestic big-box retailers. None of this actually transpired, but the ruse allowed Petters and his accomplices to borrow substantial amounts of money from unsuspecting banks and investors to maintain the scheme and fund their unearned, lavish lifestyles. At the time of its discovery (pre-Bernie Madoff), Petters's Ponzi scheme was one of the largest in American business history, with an estimated loss to its investors of more than .65 billion. See "Tom Petters," Wikipedia,

en.wikipedia.org/wiki/Tom_Petters (unless otherwise specified, all links in this article were last visited on Oct. 31, 2025).

- 3 BMO had acquired the PCI relationship when BMO bought M&I Marshall and Ilsley Bank in 2011. At the time of the acquisition, BMO paid a little more than billion for M&I, which places the size of Kelley's judgment into some context. See "BMO Financial Group to Acquire Marshall & Ilsley Corporation (M&I)," BMO, newsroom.bmo.com/2010-12-17-BMO-Financial-Group-to-acquire-Marshall-Ilsley-Corporation-M-I.
- 4 Kelley at 904 (citing Grassmueck v. Am. Shorthorn Ass'n, 402 F.3d 833, 837 (8th Cir. 2005)).
- 5 Prof. Jeffrey Davis, "Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing to Do with What Is § 541 Property of the Bankruptcy Estate," 21 Emory Bankr. Dev. J. (2005), 519, 524-25.
- 6 Kelley v. BMO Harris Bank Nat'l Ass'n, Nos. 23-2551, 23-2632, 2024 U.S. App. LEXIS 29134 (8th Cir. Nov. 14, 2024).
- 7 Kelley v. BMO Harris Bank Nat'l Ass'n, 115 F.4th 901 (8th Cir. 2024), cert. denied, 2025 U.S. LEXIS 2057 (2025).
- 8 Kelley at 906.
- 9 Minnesota Stat. § 480.065, Subd. 3 grants Minnesota's highest court the "power to answer ... a question of law certified to it by a court of the United States ... if the answer may be determinative of an issue in pending litigation in the certifying court and there is no controlling appellate decision, constitutional provision, or statute of this state."
- 10 Kelley rejected this view as a "baffling bifurcation" in his cert petition and labeled it "bizarre reverse alchemy" in submissions to the Eighth Circuit panel.
- 11 Kelley at 906.
- 12 Id. (emphasis supplied).
- 13 A "trick box" is a box that can only be opened by solving a puzzle.
- 14 BMO was found liable by a civil jury to have "aided and abetted" PCI's breach of fiduciary duty, and had a criminal fine imposed on it for million because the U.S. government alleged that the bank's "fraudulent conduct facilitated the continuation of

Petters's scheme and resulted in millions of dollars in losses to the Petters investors." "BMO Harris Bank Pays Million to Resolve Fraud Allegations," U.S. Attorney's Office for the Eastern District of California (Oct. 12, 2018), justice.gov/usao-edca/pr/bmo-harris-bank-pays-10-million-resolve-fraud-allegations.

- 15 As the hoary saying goes, "Hard cases make bad law." Here, the equities clearly favored Kelley but were not enough to persuade the panel or the Supreme Court to reconsider.
- 16 Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 346 (3d Cir. 2001) ("An analysis of standing does not include an analysis of equitable defenses, such as in pari delicto. Whether a party has standing to bring claims and whether a party's claims are barred by an equitable defense are two separate questions to be addressed on their own terms.").
- 17 Tolz v. Proskauer Rose LLP (In re Fuzion Techs. Grp. Inc.), 332 B.R. 225 (Bankr. S.D. Fla. 2005).

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Kelley v. BMO Harris Bank Nat'l Ass'n, (Kelley) 115 F.4th 901 (8th Cir. 2024).

Bankruptcy Rule

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