UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
Criminal No.: 08-320 (RHK)

UNITED STATES OF AMERICA,

Plaintiff,

v.

POSITION OF DEFENDANT WITH RESPECT TO SENTENCING FACTORS

LARRY REYNOLDS,

Defendant.

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1. Background

On October 3, 2008, Mr. Reynolds appeared before U.S. Magistrate Judge Carla M. Woerhle in the Central District of California, when he was ordered released on bond. Mr. Reynolds had previously been arrested in California by federal agents based upon probable cause concerning his involvement in the Petters Ponzi scheme.

On October 16, 2008, a one-count information was filed in the District of Minnesota, charging Mr. Reynolds with one count of conspiracy to commit money laundering, in violation of 18 U.S.C. § 1956(h). A forfeiture allegation was also included.

On October 23, 2008, Mr. Reynolds appeared before Senior U.S. District Judge Paul A. Magnuson and entered a plea of guilty as charged.

On November 4, 2008, the defendant was released on an appearance bond with electronic monitoring and reporting to U.S. Probation and Pre-Trial Services.

Since his release from custody on November 4, 2008, the defendant has travelled to Minnesota "on his own steam" numerous times for purposes of proffer sessions with the

Government, trial preparation and providing testimony in the matter of *United States v. Petters*. In the nearly 21 months since his release from incarceration, Mr. Reynolds has been in compliance with all bond conditions and has successfully remained on his electronic tether and/or curfew requirements.

2. Plea Agreement

In the plea agreement filed with this Court on October 23, 2008, Mr. Reynolds pleaded guilty to count one of the information, charging him with conspiracy to commit money laundering. The factual basis for this plea encompasses the period from about 2002 through September 2008.

The plea agreement recites that the defendant owned Nationwide International Resources ("NIR"), which was a shell corporation with respect to the Petters scheme. The bank account of NIR, at the request of Petters, received funds in the approximate amount of 12 billion dollars, virtually all of which was redirected to the account of PCI, owned by Petters. Based on an agreement with Petters, the defendant kept a percentage of the funds laundered through the NIR account.

Mr. Reynolds knew that the ostensible purpose of the wire transfers to the NIR account was to document the purchase of merchandise from NIR by Petters. The defendant knew, however, that no such purchases were being made, and that the NIR account was being used as a tool by Petters and PCI to conceal Petters' fraudulent scheme.

In the plea agreement, Mr. Reynolds agreed that he obtained over six million dollars for his role in this scheme. The pre-sentence investigation report states that Mr. Reynolds made approximately 16 million dollars as a result of the NIR/Petters "round trip" transactions. This

conclusion derived from the preliminary forensic accounting report of FBI accountant Josiah Lamb. Subsequent to the PSR, the undersigned met with Mr. Lamb and the defendant in Minneapolis, for the purpose of examining the items and methodology used by Mr. Lamb in reaching the conclusion that Mr. Reynolds had profited in the amount of approximately 16 million dollars. As a result of this cooperative meeting, Mr. Lamb has revised his conclusion as to the amount of profit derived by Mr. Reynolds in the money laundering transactions. This figure now stands at approximately 9.9 million dollars. The United States Attorney concurs.

3. Biography, Character and Criminal History of Mr. Reynolds

For purposes of this Court's assessment of the biography, character and criminal history of Mr. Reynolds, the defendant defers to the PSR, which accurately and comprehensively sets forth these topics.

No further discussion with respect to Mr. Reynolds' life history is necessary at this point, with the single request that the Court might review the numerous character reference letters and HIPAA materials which will be provided to the Court under separate cover.

As a 69-year-old white male, Mr. Reynolds' life expectancy is 14.3 years (as of October 2010).[1] Given the health issues of Mr. Reynolds, as stated in the HIPAA materials, this figure is probably optimistic.

4. Cooperation

Since his arrest by federal authorities in early October 2008, Mr. Reynolds has assisted the Government in providing complete and accurate information about the multifarious workings of the Petters Ponzi scheme. The undersigned believes that the Government will agree that Mr.

[1] *United States Life Tables*, 2006, National Vital Statistic Reports, Vol. 58, No. 21, June 28, 2010.

Reynolds' cooperation has been comprehensive, fulsome and, perhaps, extraordinary. This Court has had the opportunity to observe the demeanor and utility of Mr. Reynolds' testimony during the jury trial of Petters.

By the time Mr. Reynolds arrived in Minnesota, following his protracted incarceration in California, the Government had apparently depleted its supply of 5.K.1 motions available to defendants. Mr. Reynolds wished to cooperate at an earlier stage, but was impeded by his custodial status. Nonetheless, the defendant agreed to plead "naked" to a single count of money laundering, carrying a 20-year maximum penalty.

From the beginning, Mr. Reynolds embarked on a course of candid and, at times, painful cooperation with the government in its pursuit of bringing Petters to justice. This cooperation ran the gamut from Mr. Reynolds' waiver of pre-trial motions through numerous meetings with federal agents to provide valuable information regarding the Ponzi scheme, through the excruciating and life-threatening episode wherein Mr. Reynolds and his family were "outed" regarding WITSEC, and concluding with his withstanding the aggressive, yet ultimately ineffective, cross examination by Petters' trial counsel.

Mr. Reynolds has turned over significant assets to the Government, to be forfeited. He has assisted in the 3.1 million dollar sale of his Las Vegas residence. He relinquished valuable brokerage accounts. He also submitted to an asset deposition by the United States Attorney.

On July 13, 2001, Mr. Reynolds traveled to Minneapolis. On that date, he met for several hours with two individuals related to this case. First, Mr. Reynolds met with Jonathan Feldman, the attorney for the bankruptcy trustee for Palm Beach Finance (a victim of considerable loss in the Ponzi scheme). Mr. Reynolds provided valuable information to Mr. Feldman. Later that day, Mr. Reynolds met with FBI accountant Josiah Lamb to work through the "gain" numbers,

resulting in an agreed-upon amount. This agreement saved valuable receivership funds from being used for a defense forensic accountant; it also saved judicial resources, as an evidentiary hearing is no longer necessary in the sentencing proceedings for Mr. Reynolds.

At one point, Mr. Reynolds recalled that he had approximately 150,000 dollars in cash in a safe deposit box at a casino in Las Vegas (this was his gambling money). The undersigned obtained the key for this box, which was then given to the FBI. When the box was opened, the cash was there, as well as an additional 35,000 dollars worth of casino chips. This incident is emblematic of Mr. Reynolds' candor with the Government: it is unlikely that this box would otherwise have been discovered, and less scrupulous parties could easily have secreted this cash.

5. Advisory Sentencing Guidelines

In the plea agreement, the government and the defendant have both agreed that the Court will "consider" the United States Sentencing Guidelines as a factor in determining the appropriate sentence for Mr. Reynolds.

Based upon the sentencing guidelines and the anticipation that the defendant will receive a three-level reduction for accepting responsibility, the defendant lands at level 37 of the guidelines, resulting in an advisory guideline range of incarceration of 210 to 240 months.

The plea agreement contemplates that each party reserves the right to make motions for departures or variances from the advisory guideline range. Specifically, the defendant reserved the right to argue as follows:

A. The base offense level overstates the seriousness of the offense, because the defendant received only a small fraction of the proceeds.

B. The defendant may qualify for a downward departure and/or variance based upon his age and health.

In addition, the plea agreement contemplated other reasons for a departure, and this position pleading will discuss, *infra*, the reasons supporting a minor role reduction and a sentence which resonates proportionately with those punitive sanctions to be meted out to the various co-defendants.

6. Guidelines Overstate Criminality: Analogy to *Santos*

Pursuant to the interpretation of the term "proceeds" in *Santos*, Mr. Reynolds' advisory guideline sentence may more reasonably be informed by his $9.9 million profit. In *United States v. Santos*, 128 S.Ct. 2020 (U.S. 2008), the Supreme Court addressed ambiguity in the word "proceeds" as used in the money laundering statute, 18 U.S.C. § 1956(a)(1), noting that "proceeds" can mean either "receipts" or "profits." *Santos*, 128 S.Ct. at 2024.[2] The defendant in *Santos* had operated an illegal lottery under Indiana state law, and his money laundering convictions were based on payments he made to runners, collectors, and lottery winners – transactions that involved the receipts, but not profits, of the gambling operation. *Id.*, at 2023. The Supreme Court ultimately found inconclusive support for either statutory interpretation, and applied the rule of lenity to hold that "proceeds" means "profits," a definition that is more favorable to defendants. *Id.*, at 2025. The Court therefore upheld the lower court's decision to vacate the defendant's money laundering convictions.[3] *Id.*, at 2031.

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[2] Under § 1956(a)(1), the Government must prove that "a charged transaction 'in fact involve[d] the proceeds of specified unlawful activity' (the proceeds element), and it also must prove that a defendant knew 'that the property involved in' the charged transaction 'represent[ed] the proceeds of some form of unlawful activity' (the knowledge element)." *Santos*, 128 S.Ct. at 2023 (quoting 18 U.S.C. § 1956(a)(1)).

[3] The district court in *Santos* vacated convictions for both money laundering and conspiracy to commit money laundering, under §§ 1956(a)(1)(A)(i) and 1956(h), after finding no evidence that the transactions on which the

Under *Santos*, in order for Mr. Reynolds to be guilty of conspiracy to commit money laundering, the "proceeds" involved in his guilty plea must have been derived from the *net* proceeds of the underlying fraud allegations. The PSR in this case, however, supports a conclusion that the proceeds were based on "gross receipts" (funds laundered), not net profits. Mr. Reynolds has not made a *Santos* challenge with respect to his factual guilt. Rather, the defense feels that *Santos* is illustrative in reaching a just sentence.

In his guilty plea to the charge of conspiracy to commit money laundering, Mr. Reynolds did admit to the receipt of net profits of over six million dollars. The Government may contend that Mr. Reynolds may not argue for a *Santos*-based guidelines analysis because of a recent change in the money laundering statute of conviction extending the definition of "proceeds" to gross receipts. The United States Supreme Court has long allowed defendants to rely on cases that give the federal criminal statute under which they were convicted a more narrow interpretation than had previously been applied at the time of their conviction. *See Schriro v. Summerlin*, 542 U.S. 348, 124 S.Ct. 2519, 2522 (2004) ("New *substantive* rules generally apply retroactively [on collateral review]. This includes decisions that narrow the scope of a criminal statute by interpreting its terms.") (emphasis in original); *Bousley v. United States*, 523 U.S. 614, 118 S.Ct. 1604, 1609-10 (1998) (new interpretations of criminal statutes made after a defendant's conviction under that statute are retroactive on collateral review). The Eighth Circuit concurs. *See United States v. Ryan*, 227 F.3d 1058, 1062-63 (8th Cir. 2000) (determining that when the Supreme Court narrows the interpretation of a criminal statute enacted by Congress, that interpretation may be applied retroactively to § 2255 claims for post-conviction relief.) Accordingly, Mr. Reynolds may rely on *Santos*.

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money laundering convictions were based involved profits, as opposed to receipts. *United States v. Santos*, 342 F.Supp.2d 781, 798-99 (N.D.Ind. 2004).

The Government would be misguided in arguing that Mr. Reynolds' sentencing argument is barred by the recent Congressional amendment to the money laundering statute. The statute now includes the following definition: "the term 'proceeds' means any property derived from or obtained or retained, directly or indirectly, through some form of unlawful activity, *including the gross receipts* of such activity." 18 U.S.C. § 1956(c)(9) (effective May 20, 2009) (emphasis added). Clearly, this was an attempt by Congress to cut the heart out of the *Santos* interpretation of the term "proceeds." However, that amendment only applies to conduct committed *on or after* its effective date, May 20, 2009. The *Santos* interpretation of the term "proceeds" to mean "net profits" applies to charged conduct *prior* to that date, including the money laundering charges against Mr. Reynolds. In sum, Mr. Reynolds' sentencing position is not barred by the new amendment to the money laundering statute.

While *Santos* does not purport to interpret the federal sentencing guidelines, its reasoning can be considered in reaching a rational result. Indeed, the plea agreement contemplates this argument by the defense: "...the defendant reserves the right to argue that the base offense level overstates the seriousness of the offense because the defendant received only a small fraction of the proceeds."

Hence, through a *Santos* lens, a more appropriate measure of loss under the guidelines is the 9.9 million dollar amount, which, under § 2B1.1, would result in a 20-point increase to the base offense level, for a base offense level of 28. Adding the specific offense characteristics required by § 2S1.1(b)(2), the level will be increased by two points based upon Mr. Reynolds' conviction under 18 U.S.C. § 1956(h), for a total of 30 points. With a further adjustment for acceptance of responsibility, the total offense level, under the *Santos* analysis, is 27. Using the

sentencing guideline table, the advisory range for incarceration for Mr. Reynolds would be in the range of 70 to 87 months. With a minor role reduction, the range is 57 to 71 months.

7. Culpability and Proportionality of Co-Defendants

Oddly, the PSR does not attribute any aggravating role to any of the co-defendants remaining to be sentenced. Under § 3B1.1 of the sentencing guidelines, the following enhancements are possible, increasing the offense level:

A. Organizer or leader involving five or more participants or otherwise extensive: 4-level increase.

B. Manager or supervisor, but not organizer or leader, involving five or more participants or otherwise extensive: 3-level increase.

C. Organizer, leader, manager or supervisor in any activity other than described above: 2-level increase.

It is difficult to understand how Coleman, White, Wehmhoff, Katz, and Bell do not qualify for any of the above enhancements, given their individual status as either corporate officer and/or accounting professional, either of which presupposes a special fiduciary duty to the business entity and investors. Assuming that the participation of each of these individuals is truly "average," as concluded in the PSR, then Mr. Reynolds surely qualifies for a minor, or even minimal, role reduction in the offense level category.

The discussion, *infra*, concerning the relative roles of the remaining co-defendants is based upon the PSR and the undersigned's attendance at most of the Petter's trial, and the evidence adduced during that trial.

It is anticipated that the Government will deride the utility of this comparative culpability/proportionality analysis based on a simplistic argument that Mr. Reynolds has no co-defendants in his money laundering information. This argument fails because the charge of conviction for Mr. Reynolds is *conspiracy* to commit money laundering based on 18 U.S.C. § 1956(h). This crime necessarily involves other individuals. Hence all the co-defendants are brought into the analysis.

Coleman and White were both officers of PCI (PSR ¶ 65). The birth and perpetuation of the Ponzi scheme itself, through the fabrication of phony documents, was performed by both Coleman and White. As Petters stated in a recorded conversation with Coleman, "I am in it with you and Bob." (PSR ¶ 21)

As a corporate officer, Coleman planned, managed, and owed a fiduciary duty to the corporation and to the investors. It is undisputed that Coleman prepared false documents, and committed mail or wire fraud by transmitting these documents. The testimony at trial also showed that Coleman stole money from Petters, and failed to report these items on her tax returns.

All of the above conduct attributable to Coleman applies, with equal force, to White.

Coleman and White both stole from Petters himself. Petters set up a shell corporation, Onka, through which funds passed. Coleman and White each stole approximately one million dollars from this Onka account. Expert accountant Jim Fischer testified at the Petters trial that Coleman and White each committed tax evasion, as well, with respect to these purloined monies.

Wehmhoff, a certified public accountant, was also an executive vice president of PGW. (PSR ¶ 57) As such, he had an independent professional duty of candor, as well as a fiduciary duty to PGW and to the investors. Nonetheless, as executive vice president, overseeing the tax

department for PGW, he prepared false tax documentation for PGW and other entities owned by Petters, including PCI, and for Petters' personal tax filings. The tax loss attributable to Wehmhoff's fraudulent returns is approximately 20 million dollars. Wehmhoff also falsely characterized loan payments, misreported tax items as gifts, and failed to report income. It is obvious that Wehmhoff worked in lock-step with Petters in planning, managing and implementing the tax fraud necessary to sustain, at least temporarily, the Ponzi scheme itself.

Katz was a certified public accountant and, as such, had an independent professional fiduciary duty imposed by that status. In addition, Katz was hired as the vice president of finance and accounting for Lancelot Funds. In his role as both CPA and corporate officer, Katz breached his fiduciary duties to both his profession and to the investors of Lancelot Funds. (PSR ¶ 42) In 2008, Katz conspired with Bell and other individuals at PCI to make and implement approximately 86 fraudulent banking transactions that gave investors false impressions of financial security.

Bell was the founder and manager of several hedge funds, most importantly Lancelot Funds. He made all significant decisions for these hedge funds. (PSR ¶ 40) Bell conspired with Katz in falsely reporting extensions of repayment to the fund. (PSR ¶ 44) He also initiated and conspired with Katz to make approximately 86 fraudulent banking transactions (round trips). Counterfeit promissory notes and invoices were also apparently employed by Bell. (PSR ¶ 48)

Catain is the co-defendant most similarly situated to Mr. Reynolds; however, there are important distinctions. First, Catain made over 16 million dollars for his role in the scheme. In addition, Catain would frequently bring bags of "cabbage," meaning cash money, to Petters throughout the scheme. These nefarious deliveries were most certainly undeclared cash, and earns Catain a point for tax evasion in the chart below. Finally, Catain was caught pilfering from

the till at the car wash, then a receivership asset, resulting in his temporary incarceration, and earning him a point for theft in the chart below.

Catain is going to receive the benefit of a 5.K.1 motion by the Government. He is enjoying this benefit only because he jumped on the opportunity to cooperate prior to Mr. Reynolds, who was mired in California confinement proceedings at the time. It is certain, however, that the quality and quantity of Mr. Reynolds' cooperation with the Government significantly outweighs that provided by Catain.

It is important for the Court to note the relative gain realized by each co-defendant in assessing proportional culpability. Based on information received from FBI accountant Josiah Lamb on July 27, 2010, the Government's "best estimate" so far as to the parties' gain is as follows:

Coleman – Approx. $14,382,000
White – Approx. $14,559,000
Wehmhoff – Pled to tax charges approx. $5,000,000 in bonuses
Bell – Over $70,000,000
Katz – Salary $150,000
Catain – Approx. $16,679,000

In the proportionality/culpability chart below, it is assumed that each person knowingly participated in the preparation of documents and the doing of acts which necessarily were transmitted or could not be effective without the use of United States mail, bank wires, e-mails or other instrumentalities of interstate commerce. This is, most likely, a valid assumption. Hence, each participant is given a point for mail/wire fraud.

Assuming the overall accuracy of this methodology to measure culpability, it is clear that Mr. Reynolds was merely a cog in the vast Petters machine. Only Mr. Reynolds and Catain did not breach any fiduciary duty to companies or investors, because neither was a corporate officer, nor engaged in a professional capacity, such as an accountant, for any business entity or purpose.

Mr. Reynolds was nothing more than the switchman of the washing machine in the money laundering operation developed and fueled by Petters, Coleman, White and Wehmhoff.

DEFENDANT	Duty Breach	Plan/ Manage	False Docs	Mail/ Wire Fraud	Theft	Tax Evasion	Profit Over $10M	TOTAL
Coleman	X	X	X	X	X	X	X	7X
White	X	X	X	X	X	X	X	7X
Bell	X	X	X	X			X	5X
Wehmhoff	X	X	X	X		X		5X
Katz	X	X	X	X				4X
Catain				X	X	X	X	4X
Reynolds				X				1X

8. Government Position Pleading

The undersigned is in receipt of the Government's position regarding sentencing, which was recently filed.

Although Mr. Reynolds has zero criminal history under the sentencing guidelines, the Government cannot resist disinterring and browbeating Mr. Reynolds with his past. The Government calls Mr. Reynolds "a professional fraudster," noting that he "would not act alone." In response, the defense submits that these past criminal enterprises would have existed with or without Mr. Reynolds. With Mr. Reynolds' involvement and cooperation, however, these enterprises were dismantled and co-defendants were convicted. If anything, Mr. Reynolds has been an historical ally and asset for the Government.

Finally, the Government notes that Mr. Reynolds is the subject of possible contempt proceedings with the Receiver in the parallel civil action. This attempt at constructive civil

contempt seeks only to have Mr. Reynolds reverse what was essentially a default divorce decree. Mrs. Reynolds was the moving party in the divorce, and Mr. Reynolds was unrepresented. Nonetheless, both Mr. and Mrs. Reynolds have agreed to nullify the effect of the property division portions of the decree vis-à-vis the Receiver's interests, mooting the purpose of constructive contempt (to compel an act). This offer has, inexplicably, been spurned by the Receiver.

9. Conclusion

For the above reasons, and grounded on a proportionality/culpability analysis, the undersigned respectfully requests a sentence of incarceration for Mr. Reynolds in the range of 48 months. In addition, the undersigned respectfully requests that Mr. Reynolds be given day-for-day credit against any term of incarceration, for the approximately 21 months of his *de facto* confinement by virtue of his house arrest and/or curfew conditions of release.

Dated: 7/30/10

Respectfully submitted,

BRUNO & NELSON

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