No. 14-1128, No. 14-1129

In the Supreme Court of the United States

IRVING H. PICARD, TRUSTEE FOR THE LIQUIDATION OF BERNARD L. MADOFF INVESTMENT SECURITIES LLC,
Petitioner,

v.

IDA FISHMAN REVOCABLE TRUST, ET AL.,
Respondents.

SECURITIES INVESTOR PROTECTION CORPORATION,
Petitioner,

v.

IDA FISHMAN REVOCABLE TRUST, ET AL.,
Respondents.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Did the court of appeals err in unanimously concluding that the payments at issue, made by a conceded "stockbroker" (Madoff Securities) to its innocent customers, are shielded from claw back under 11 U.S.C. § 546(e), because the payments were "made in connection with a securities contract" or, alternatively, were "settlement payment[s]"?

RULE 29.6 STATEMENT

Because of the number of respondents joining this brief, a compendium of corporate disclosure statements required under Supreme Court Rule 29.6 is separately filed with the Clerk of the Court.

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INTRODUCTION

This case concerns the scope of a trustee's authority under the Bankruptcy Code to "claw back" pre-bankruptcy transfers made by Madoff Securities to its good-faith customers, respondents here. Both the Second Circuit and the district court recognized that the answer to the question must be determined based on the statutes that Congress enacted. And, as both courts below held, the text of Section 546(e) of the Bankruptcy Code and related provisions unambiguously compel the conclusion that the Trustee's powers do not extend to the payments at issue here—payments to Madoff Securities' innocent customers that are not actual fraudulent transfers within the two-year federal reach-back period.

That conclusion is firmly grounded on two independent, alternative holdings reached by both the Second Circuit and the district court. Specifically, Section 546(e) shields the transfers here both as payments made "in connection with a securities contract," and as "settlement payments." Both holdings are unassailable. As the Second Circuit observed, petitioners' main argument to the contrary—that Section 546(e) should not apply because Madoff Securities did not actually complete the securities transactions it purported to make—simply does not "engage with the language Congress chose." Pet. App. 20a-21a. And far from conflicting with the decision of any other circuit, the decision below accords with the decisions of other circuits, which also have given effect to Section 546(e)'s broad terms.

Petitioners' real complaint is not with the reasoning of the Second Circuit, but with the statute Congress enacted. In essence, petitioners ask this Court to legislate a "Ponzi scheme exception" to Section 546(e). But while Congress has revisited Section 546(e) several times, *see* Add. 15a-16a n.3, it has not enacted the exception that petitioners and their amici ask for here. The statute Congress did enact, however, allows the trustee to avoid any transfers made by the debtor with an "actual intent to hinder, delay, or defraud" creditors within the two years preceding a bankruptcy filing. 11 U.S.C. § 548(a)(1)(A); *see id.* § 546(e) (excepting Section 548(a)(1)(A) transfers from Section 546(e)). Petitioner Picard is pursuing billions of dollars under that very exception, including claims against respondents here. Those pending claims, which Picard largely ignores, are not affected by the decision below.

The petitions should be denied.

STATEMENT OF THE CASE

A. Statutory Background

In certain situations, the Bankruptcy Code authorizes the trustee of a debtor's estate to obtain the return of prior payments made by the debtor. *See generally* 11 U.S.C. §§ 544-50. In the language of the Code, the trustee may "avoid" (or unwind) the specified "transfers" and obtain recovery of the paid-out funds for the debtor's estate for distribution to the debtor's creditors according to the applicable law.

Under 11 U.S.C. § 548, a trustee may avoid transfers that occurred within the two years before the bankruptcy filing if, *inter alia*, the transfers were made (1) "with actual intent to hinder, delay, or defraud" creditors, *id.* § 548(a)(1)(A), or (2) by an insolvent transferor without "a reasonably equivalent value in exchange for such transfer," *id.* § 548(a)(1)(B). The former are generally referred to as actual fraudulent transfers and the latter as constructive fraudulent transfers. Pet. App. 11a. Preferences—payments made by the debtor to its creditors while insolvent leading up to the bankruptcy filing—are another type of avoidable transfer. 11 U.S.C. § 547(b).

A trustee also may avoid any transfer that an unsecured creditor could avoid under applicable state law. *Id.* § 544(b). The applicable state law here—New York's fraudulent conveyance law—allows creditors to avoid actual or constructive fraudulent transfers going back six years. N.Y. Debt. & Cred. Law §§ 273-76; *see* N.Y. C.P.L.R. 213.

Congress has long recognized that bankruptcies of stock brokerage firms may have a ripple effect on the securities market. *See* H.R. Rep. No. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583 (recognizing that, given the complex and sometimes volatile nature of the securities market, the insolvency of one firm may threaten the market). That concern is manifest when a bankruptcy threatens to unwind settled transactions by clawing back from market participants years-old payments that have since been spent or reinvested. Recognizing this unique threat, Congress exempted certain securities-related transfers from a trustee's avoidance powers. *Id.* at 2, *reprinted in* 1982 U.S.C.C.A.N. at 583-84.

Section 546(e) of the Bankruptcy Code prohibits a trustee from avoiding a constructive fraudulent transfer, preference, or transfer avoidable under state law pursuant to Section 544(b) when that transfer "is a . . . *settlement payment*, as defined in section 101, 741, or 761 of this title, or made by or to (or for the benefit of) a . . . stockbroker . . . , or [2] . . . is a transfer made by or to (or for the benefit of) a . . . stockbroker . . . *in connection with a securities contract*, as defined in section 741(7) . . . of this title." 11 U.S.C. § 546(e) (emphases added). But Section 546(e) explicitly exempts—and thus allows a trustee to seek claw back of—transfers specified in Section 548(a)(1)(A), *i.e.*, actual fraudulent transfers made within the two years before the bankruptcy filing. *See id.*

The Bankruptcy Code defines "stockbroker" as a person (which includes a partnership or corporation, *id.* § 101(41)), for which there is a "customer," and which is "engaged in the business of effecting transactions in securities . . . for the accounts of others," or "with members of the general public, from or for such a person's own account." *Id.* § 101(53A); *see id.* § 741(2) (defining "customer").

The Bankruptcy Code defines "securities contract" expansively to include ten types of agreements or transactions. Three are relevant here: "a contract for the purchase, sale, or loan of a security," *id.* § 741(7)(A)(i); "a master agreement," *id.* § 741(7)(A)(x); and a "security agreement or arrangement related to any agreement or other credit enhancement or transaction referred to in this subparagraph, including any guarantee or reimbursement obligation by or to a stockbroker," *id.* § 741(7)(A)(xi). The Code also includes an eleventh, catch-all category that brings within the protection of Section 546(e) "any other agreement or transaction that is similar to an agreement or transaction referred to" in the definition. *Id.* § 741(7)(A)(vii).

The Bankruptcy Code likewise expansively defines the "settlement payment[s]" that fall within Section 546(e)'s protection. These payments include any transfer that is "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." *Id.* § 741(8).

The Securities Investor Protection Act (SIPA), 15 U.S.C. §§ 78aaa *et seq.*, created "a new form of liquidation proceeding" for failed securities brokerage firms. *Securities Investor Prot. Corp. v. Barbour*, 421 U.S. 412, 416 (1975). SIPA also created the Securities Investor Protection Corporation (SIPC), a federally chartered nonprofit corporation, of which federally registered securities brokers must be members. 15 U.S.C. § 78ccc(a)(2)(A). Under SIPA, trustees have specific responsibilities for seeking the return of securities to customers and pooling remaining securities to satisfy customers' claims. *Id.* §§ 78fff(a)(1)(A), 78fff(a)(1)(B), 78fff-2(b), 78fff-2(c)(2), 78lll(3). When there is a shortfall in customer property on hand, the trustee is authorized to seek to avoid and recover (or claw back) money previously paid to customers by the failed brokerage firm "which, except for such transfer[s], would have been customer property." *Id.* § 78fff-2(c)(3); *see* Pet. App. 10a.

But significantly, SIPA expressly limits a SIPA trustee's authority to claw back transfers only to those transfers that are void or voidable under the provisions of the Bankruptcy Code. 15 U.S.C. § 78fff-2(c)(3); *see id.* § 78fff-1(a).

B. Factual Background[1]

Madoff Securities was a securities brokerage firm registered with the Securities and Exchange

[1] Because this case was resolved on a motion to dismiss, respondents assume for the purpose of this brief that the facts alleged in the complaint are true.

Commission, which "as a whole engaged in 'legitimate trading' through its [unincorporated] market making and proprietary divisions." Pet. App. 32a, 36a. Respondents were customers who dealt with the firm's unincorporated investment advisory unit, which was at the heart of the now infamous fraud. *Id.*

To open securities trading accounts, customers, including respondents, entered into three written agreements with Madoff Securities—a "Customer Agreement," a "Trading Authorization Limited to Purchases and Sales of Securities and Options," and an "Option Agreement." *Id.* at 17a, 32a. Collectively, these account documents were "pretty standard fare" for securities documents. C.A. Oral Arg. Tr. 23 (acknowledgement by counsel for petitioner SIPC); Picard C.A. Br. 22, ECF No. 145 ("[T]hese types of documents are routinely used to initiate the customer-broker relationship.").

The Customer Agreement authorized Madoff Securities to "open[] or maintain[] . . . one or more accounts" for investing "money, securities, financial instruments of every kind and nature and related contracts and options . . . currently or hereafter held, carried, or maintained by [Madoff Securities] . . . in and for any of [the customer's] accounts . . . ." Customers Jt. C.A. Br. 5, ECF No. 272 (alterations in second quotation in original); Pet. App. 17a. The "Trading Authorization" appointed Madoff Securities as the customer's "'agent and attorney in fact to buy, sell and trade in stocks, bonds, and any other securities in accordance with [Madoff Securities'] terms and conditions for the [customer's] account.'" Pet. App. 17a (second alteration in original) (citation omitted). The Option Agreement authorized Madoff Securities to engage in options trading for the customer's account. *Id.* These agreements also gave Madoff Securities the discretion to liquidate securities in the customers' accounts as necessary to implement their sell orders and withdrawal requests. *Id.* at 27a.

After executing these contracts, Madoff Securities customers deposited funds into their discretionary trading accounts. Customers Jt. C.A. Br. 5. Madoff Securities then purported to execute a "'split strike conversion strategy'" with those funds. Pet. App. 9a. Such a strategy entailed "timing the market to purchase a basket of stocks on the S&P 100 Index, and then hedging those purchases with related options contracts." *Id.* Madoff Securities provided its customers, including respondents, periodic statements showing positions, trades, and account values, as well as confirmations and other communications. *Id.* at 10a; Customers Jt. C.A. Br. 5.

It is alleged, however, that Madoff Securities did not undertake actual securities or options trading on its customers' behalf. Rather, it allegedly kept the customers' funds in a single, commingled bank account. When a customer requested a withdrawal from his account, Madoff Securities would pay the customer from that account and reflect on the customers' statement the securities sales supposedly necessary to fund the withdrawal. Pet. App. 10a. It is undisputed that respondents here—Madoff Securities customers—were unaware of the fraud until it was disclosed. *Id.* at 46a n.9 ("[T]he Trustee does not allege that the defendants either knew of the fraud or should have known of it . . . .").

Madoff Securities' fraud was exposed in December 2008 and the firm collapsed. *Id.* at 10a In response, SIPC petitioned for a protective order and the district court appointed Picard as trustee under SIPA. *Id.*

C. District Court Proceedings

Picard filed numerous suits against Madoff Securities customers, including respondents, to recover the funds disbursed from their accounts before the Madoff Securities fraud was exposed. *Id.* at 32a.

Picard generally pursued two theories of recovery. First, he argued that the withdrawals made within the two years before the SIPA liquidation filing were voidable under 11 U.S.C. § 548 as both actual (§ 548(a)(1)(A)) and constructive (§ 548(a)(1)(B)) fraudulent transfers. Pet. App. 10a-11a. Second, he argued that the withdrawals made within the six years before the filing were voidable under 11 U.S.C. § 544(b) and New York's fraudulent conveyance law, N.Y. Debt. & Cred. Law §§ 273-76, which has a six-year statute of limitations, *see* N.Y. C.P.L.R. 213. Pet. App. 11a. In some cases, Picard also sought to recover transfers to customers made within 90 days of the filing date as preferences under 11 U.S.C. § 547.

Madoff Securities customers, including respondents, moved to dismiss, arguing that Section 546(e) exempted from avoidance the constructive fraudulent transfers, preferences, and the transfers that otherwise could be reached by state law because the transfers either qualified as "settlement payments" made by a stockbroker, or as payments made by a stockbroker "in connection with a securities contract," or both. Pet. App. 13a-14a, 31a, 34a. Thus, the primary focus of the customers' motions was the payments they received between 2002 and 2006—payments that were not alleged to be actual fraudulent transfers within the two-year reach-back period under federal law (Section 548(a)(1)(A)) but instead fraudulent transfers within the six-year reach-back period under New York law. *See id.* at 34a.

The district court agreed with the customer defendants that Section 546(e) barred the recovery of the transfers at issue. *Id.* at 34a-35a; *see also id.* (incorporating by reference the district court's previous decision on the same issues in *Picard v. Katz*, 462 B.R. 447, 452 n.3 (S.D.N.Y. 2011), which is reprinted in the addendum to this brief[2]). The court based that conclusion on its findings that Madoff Securities was a "stockbroker," and that the withdrawals made by its customers were both "made in connection with a securities contract" and, in the alternative, "settlement payments" under Section 546(e). *Id.* at 37a-41a; Add. 15a-16a.

The district court concluded that the Bankruptcy Code's "extremely broad" definition of "settlement payment" "clearly include[d] all payments made by Madoff Securities to its customers." Add. 14a; Pet. App. 39a-40a. The court further found that "any payment by Madoff Securities to its customers that somehow does not qualify as a 'settlement payment' qualifies as a 'transfer' made 'in connection with a securities contract.'" Add. 14a; Pet. App. 39a.

[2] The district court later amended its decision in *Katz* with respect to an issue unrelated to this case. *See Securities Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff Sec.)*, No. 12 MC 115, 2013 U.S. Dist. LEXIS 187380 (S.D.N.Y. Feb. 12, 2013) ("The Court therefore departs from the reasoning set forth in the first full paragraph of page 456 of *Picard v. Katz*, which the Court no longer finds persuasive in this limited respect."). That amendment did not affect the portions of *Katz* cited in this brief.

The district court rejected Picard's argument that it should "ignore" the statutory language and observed, in any event, that application of Section 546(e) to the payments at issue was perfectly consistent with Congress's objective. Add. 15a-16a n.3; Pet. App. 42a. As the court explained, "given the magnitude of Madoff Securities—4,900 clients and $65 billion under management in 2008—avoidance of its transfers to clients, who included other investment businesses, would likely cause the very 'displacement' that Congress had hoped to minimize." Pet. App. 43a (citation omitted).

At the same time, the district court made clear that Picard could pursue his claims under the federal two-year actual-fraud provision, 11 U.S.C. § 548(a)(1)(A)—exempted from Section 546(e). Pet. App. 44a.

D. Court of Appeals Decision

The court of appeals unanimously affirmed. *Id.* at 2a-3a. As the court explained at the outset, because "[i]t is not disputed that [Madoff Securities] was a 'stockbroker' for the purposes of § 546(e)," the appeal "turn[ed] on whether the transfers either were 'made in connection with a securities contract' or were 'settlement payment[s].'" *Id.* at 14a-15a.

The court of appeals first considered whether the transfers were "made in connection with a securities contract." The court explained that "the term 'securities contract' expansively includes contracts for the purchase or sale of securities, as well as any agreements that are *similar* or *related* to contracts for the purchase or sale of securities." *Id.* at 16a-17a. That concept is "broadened even farther," the court noted, by Section 546(e)'s protection of transfers made "'in connection' with a securities contract." *Id.* at 17a.

The court had no difficulty concluding that the account documents fell within the provision's broad sweep—finding that the agreements between Madoff Securities and its customers were "securities contracts" under four separate provisions of the statute, including the broad, catch-all provision covering "'*any* other *agreement* or transaction that is *similar to*'" one of the enumerated agreements or transactions. *Id.* at 19a.

The court rejected Picard's argument that the account documents could qualify as securities contracts "only . . . if Madoff had actually completed the securities transactions he purported to effectuate." *Id.* at 15a. That argument, the court explained, "does not engage with the language Congress chose for § 741(7) and § 546(e)," and imposes a purchase-or-sale requirement that the act does not contain. *Id.* at 20a. The court also rejected Picard's argument that the transfers at issue did not implicate the concerns that motivated Section 546(e), explaining that "[p]ermitting the clawback of millions, if not billions, of dollars from [Madoff Securities] clients—many of whom are institutional investors and feeder funds—would likely cause the very 'displacement' that Congress hoped to minimize in enacting § 546(e)." *Id.* at 22a.

The court also "ha[d] little difficulty" concluding that the customers' withdrawals were made "'in connection with'" those contracts—a requirement that is met if a transfer is merely "'related to' or 'associated with' the securities contract." *Id.* at 24a-25a (quoting *Webster's 3d New Int'l Dictionar*y 481 (1993)). The court rejected Picard's argument that "Ponzi scheme payments, by definition, are not 'in connection with' a securities contract." *Id.* at 25a. All that is required, the court explained, is "that the transfer have a connection to the securities contract, which these payments do." *Id.* at 26a. "[T]he fact that a payment was made in connection with a Ponzi scheme does not mean that [it] was not at the same time made in connection with a (breached) securities contract." *Id.*

Finally, the court concluded that the withdrawals were "'settlement payments,'" providing "another basis" to exempt them from the Trustee's avoidance powers. *Id.* A "settlement payment," the court explained, is "'the transfer of cash or securities made to complete [a] securities transaction.'" *Id.* at 27a (citation omitted). And each time a Madoff Securities customer requested a withdrawal, "he or she intended that Madoff Securities dispose of securities and remit payment to the customer." *Id.* Thus, the court concluded, the payment the customer received as a result of that request was a "settlement," regardless whether the broker "failed to execute" the necessary trade. *Id.*

The court concluded its opinion by observing that, "by enacting § 546(e), Congress provided that, for a very broad range of securities-related transfers, the interest in finality is sufficiently important that they cannot be avoided by a bankruptcy trustee at all, except as actual fraudulent transfers under § 546(a)(1)(A)." *Id.* at 29a. "We are obliged," the court stated, "to respect the balance Congress struck among these complex competing considerations." *Id.*

REASONS FOR DENYING THE WRITS

I. THE SECOND CIRCUIT CORRECTLY GAVE EFFECT TO THE BROADLY WORDED PROVISIONS AT ISSUE

Petitioners primarily challenge the correctness of the Second Circuit's interpretation of the statutory provisions at issue. Error correction, of course, is not typically a sufficient basis for certiorari. *See* Sup. Ct. R. 10. And in this case, there was no error. The Second Circuit properly gave effect to the statute Congress wrote, recognizing that it was "not [its] place to legislate another approach." *T-Mobile S. LLC v. City of Roswell*, 135 S. Ct. 808, 818 (2015).

A. It Is Undisputed That Madoff Securities Was A "Stockbroker"

While petitioners largely ignore the fact, it is undisputed that Madoff Securities was a "stockbroker" for purposes of Section 546(e). Pet. App. 14a. That fact alone distinguishes this case from those cited by petitioners in this regard. The "Ponzi scheme" cases relied on by Picard (Picard Pet. 27-28), for example, involved the question of whether the debtor was a stockbroker at all. *See Johnson v. Neilson (In re Slatkin)*, 525 F.3d 805, 816 (9th Cir. 2008); *Wider v. Wootton (In re Wider)*, 907 F.2d 570, 571 (5th Cir. 1990). When the answer is no, as in those cases, the stockbroker provision in Section 546(e) does not apply. This case, in contrast, indisputably involves a stockbroker.

B. The Transfers Were "Made In Connection With A Securities Contract"

The Second Circuit correctly held that the transfers at issue are not avoidable because they were made by a stockbroker "in connection with a securities contract."

As the Second Circuit recognized, Congress defined "securities contract" "expansively." Pet. App. 16a, 19a. For an agreement to qualify as a "securities contract" under Section 546(e), it need satisfy only one of the eleven definitions of that phrase in 11 U.S.C. § 741(7). These definitions cover a wide range of securities industry agreements and transactions—giving the term an "extraordinary breadth." *Id.* at 15a. Respondents' account documents—which Picard conceded below were "pretty standard fare" for securities documents, C.A. Oral Arg. Tr. 23; *see also* Picard C.A. Br. 22—satisfied at least four of those independent definitions. Any one is enough.

First, the account documents are "contract[s] for the purchase, sale, or loan of a security . . . or . . . option to purchase or sell any such security." 11 U.S.C. § 741(7)(A)(i); *see also* Pet. App. 18a. While neither the Bankruptcy Code nor SIPA defines purchase or sale, the Securities Exchange Act of 1934—of which SIPA is a part—defines the terms to "include[] *any* contract to buy, purchase, or otherwise acquire . . . [or] to sell or otherwise dispose of" a security. 15 U.S.C. § 78c(a)(13)-(14) (emphasis added). There can be no doubt that, on their face, the account documents are agreements between Madoff Securities and respondents for the acquisition and disposition of securities. The agreements authorize Madoff Securities "'to buy, sell and trade in stocks'" for its customers, make reference to securities transactions that "'shall be subject'" to the securities laws, and promise that customers' "'funds w[ill] be invested in a basket of [public company] common stocks'" and that "[Madoff Securities] w[ill] 'hedge such purchases with option contracts.'" Pet. App. 38a (citation omitted).

Second, the agreements qualify as master agreements under 11 U.S.C. § 741(7)(A)(x). Picard himself acknowledges that a "master agreement" is an agreement that applies to a series of transactions with largely overlapping terms. Picard Pet. 21; *see* Pet. App. 18a. That is exactly what the account documents do—provide the framework for the numerous securities transactions that Madoff Securities was to undertake on its customers' behalf. Pet. App. 18a-19a.

Third, the account documents are "securit[ies] agreement[s]" as that term is used in Section 741(7)(A)(xi). By obligating Madoff Securities to reimburse its customers on request, the documents fall within the provision's "expansive" definition, which includes "any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this subparagraph, including any guarantee or reimbursement obligation by or to a stockbroker." 11 U.S.C. § 741(7)(A)(xi); *see also* Pet. App. 19a.

Fourth, the agreements fall within the statute's catch-all provision, which covers "*any* other agreement or transaction that is *similar* to an agreement or transaction referred to in this subparagraph." 11 U.S.C. § 741(7)(A)(vii) (emphasis added); *see also* Pet. App. 20a. If the account documents are not a contract for the sale or purchase of a security, they are at least *similar to* such a contract because they created the relationship between Madoff Securities and its customers pursuant to which Madoff Securities was to purchase and sell securities for those customers, honor their withdrawal requests, and remit proceeds to them. *See* Pet. App. 19a-20a. The account documents are also at least "similar to" master agreements, in that they provide the over-arching framework for the broker-customer relationship and specify the types of trades that Madoff Securities was to effectuate. This "characteristic in common" with master agreements is sufficient for the account documents to fall under the broadly worded catch-all provision.

The only remaining question is whether the payments made by Madoff Securities to its customers were "in connection with" the securities contracts. As the Second Circuit held, the answer is clearly yes. *Id.* at 26a. Madoff Securities paid its customers pursuant to its obligations as set forth in the account documents, which is all that Section 546(e)'s "low bar" requires. *Id.*; *see id.* at 21a ("Section 546(e) only requires that a covered transfer be broadly related to a 'securities contract,' not that it be connected to an actual securities transaction."). That conclusion is consistent with this Court's decisions interpreting the phrase "in connection with" in the related securities fraud context. *See* 15 U.S.C. § 78j(b) ("in connection with the purchase or sale of any security"); 17 C.F.R. § 240.10b-5(c); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 n.10 (2006) ("'[A] broker who accepts payment for securities that he never intends to deliver . . . violates § 10(b) and Rule 10b-5.'" (citation omitted)); *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (SEC may bring a public enforcement action against a broker who accepted payment for securities that he never delivered).

As the Second Circuit recognized, Picard's argument that Madoff Securities did not actually carry out the securities transactions contemplated by the agreements, Picard Pet. 19, "does not engage with the language that Congress chose for § 741(7) and

§ 546(e)," Pet. App. 20a. Nowhere in the statute does it say that the securities contract must be fully performed. Nor does the statute contain any "purchase or sale requirement." *Id.* Instead, the statute focuses on the existence of agreements or contracts for the purchase or sale of securities, which—breached or not—is exactly what Madoff Securities entered into with its customers, including respondents. *See generally* C.A. Oral Arg. Tr. 53-54 (statement by counsel for petitioner Picard that agreement between two parties for the purchase of securities is, regardless of whether it is performed, a contract for the purchase or sale of securities).

Moreover, if Congress had wanted the definition of securities contract to turn on whether an actual securities transaction occurred, it would have used the phrase "securities transaction" in the definitions of "securities contract" at issue in this case (11 U.S.C. § 741(7)(A)(i), (vii), (x), and (xi)) just as it did in two of the definitions not at issue here. *See id.* § 741(7)(A)(v), (vi).

Picard's suggestion (Picard Pet. 20) that the account documents created a relationship between Madoff Securities and its customers similar to the relationship between a real estate broker and a homebuyer misses the mark. The typical real estate broker holds only a limited agency to assist in the purchase or sale of specific real property. A realtor's brokerage agreement does not permit the broker unilaterally to purchase or sell homes, or to obligate the principal to purchase a particular property. *See Friedman v. New York Tel. Co.*, 176 N.E. 543, 544 (N.Y. 1931) (Real estate brokers are negotiators; transactions "must be consummated by the principals."). Madoff Securities, in contrast, not only had authority to purchase and sell securities on behalf of its customers, but also was obligated to do so. It "promised its customers that it would transact securities," Pet. App. 25a, in accordance with the discretionary trading arrangement set forth in the account documents.

C. The Transfers Qualify As "Settlement Payments" As Well

The Second Circuit correctly concluded that the transfers at issue are not avoidable because they were "settlement payment[s]" under 11 U.S.C. § 741(8)—an independent basis for holding that Section 546(e) prevented Picard from avoiding those transfers.

Section 741(8) defines "settlement payment" expansively to include preliminary, partial, and interim settlement payments, or "a settlement payment on account, a final settlement payment, or *any* other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8) (emphasis added). Recognizing Congress's decision to protect a wide variety of payments, the courts of appeals have consistently described the definition as "'"extremely broad."'" *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.)*, 571 F.3d 545, 549-50 (6th Cir. 2009) (citation omitted), *cert. denied*, 558 U.S. 1148 (2010); *see also Grayson Consulting, Inc. v. Wachovia Sec., LLC (In re Derivium Capital LLC)*, 716 F.3d 355, 364 (4th Cir. 2013) (collecting cases); *Jonas v. Resolution Trust Corp.*, 971 F.2d 322, 326 (9th Cir. 1992).

As the Second Circuit held, the transfers here easily fall within Congress's broad definition of "settlement payment." Pet. App. 26a-27a. Madoff Securities' written crediting of securities to its customers' accounts created an enforceable securities entitlement in those customers, and each customer's withdrawal request amounted to an order to dispose of his or her securities and remit payment on the customer's account. *See* N.Y.U.C.C. § 8-501(b)(1) & cmt. 2; Pet. App. 27a. A customer's withdrawal request thus initiated a securities transaction. And when Madoff Securities paid its customers in response to their withdrawal requests, as required by both the account documents and New York law, Pet. App. 27a, it completed the securities transaction the customers had initiated with their stockbroker.

Again, petitioner Picard's allegation that Madoff Securities did not actually buy or sell any securities for respondents misses the point. Nowhere does Section 546(e) require the actual purchase or sale of a security; indeed, the "settlement payment" provision does not even refer to the purchase or sale of securities. The provision protects the securities market not by focusing on whether a security was actually bought or sold but by focusing on who was involved in a given agreement or transaction. Congress's focus on market participants protects against the very threat posed by this litigation—that a stockbroker's innocent customers might be required to liquidate their assets to disgorge payments they received years before the broker's bankruptcy despite having reinvested or otherwise spent those funds. Nothing in either the Bankruptcy Code or SIPA compels such a draconian result.

D. SIPA Does Not Alter The Meaning Of The Provisions At Issue

The SIPA provision that allows for the application of the Bankruptcy Code in SIPA liquidations "'[t]o the extent consistent with the provisions'" of SIPA, Picard

Pet. 25-26 (alteration in original) (citing 15 U.S.C. § 78fff(b)), does not change this result. Petitioners do not identify a single provision of SIPA with which the decision below conflicts, and there is none. Moreover, their reliance on what they suppose was Congress's "purpose" and "intent" cannot overcome the plain language of Section 546(e). As this Court has repeatedly warned, "it frustrates rather than effectuates legislative intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law." *Rodriguez v. United States*, 480 U.S. 522, 526 (1987) (per curiam). Yet that is just what petitioners urge—an interpretation based on their view of Congress' legislative intent instead of the law itself. *E.g.*, Picard Pet. 11, 28; SIPC Pet. 6, 28, 36.

Further, while relying on SIPA's *general* provision regarding the applicability of the Bankruptcy Code, petitioners ignore the *specific* SIPA provision that addresses trustee claw backs. That provision states that a SIPA trustee "may recover any property transferred by the debtor . . . *if and to the extent that such transfer is voidable or void under the provisions of [the Bankruptcy Code]*." 15 U.S.C. § 78fff-2(c)(3) (emphasis added). Even if there were a conflict—and petitioners have not identified one—that specific provision would control over the more general one—§ 78fff(b). *See Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 170 (2007) ("[N]ormally the specific governs the general.").

Petitioners' view of SIPA's purpose—if relevant at all—also fails to account for Congress's actual goals. SIPC and Picard view SIPA's goal as essentially the collection of money. *See* SIPC Pet. 4 ("The goal of SIPA is to reinforce investor confidence by instilling in customers the knowledge that even if their broker fails financially, cash and securities that they entrusted to their broker will be returned to them."); Picard Pet. 25 (the "principal goal" of SIPA is "the creation of a complete pool of customer property for pro rata distribution"). But SIPA is aimed at much more.

Congress enacted SIPA both to "restore investor confidence in the capital markets[] and [to] upgrade the financial responsibility requirements for registered brokers and dealers." *Securities Investor Prot. Corp. v. Barbour*, 421 U.S. 412, 415 (1975); *see* H.R. Rep. No. 91-1613, at 2-4 (1970), *reprinted in* 1970 U.S.C.C.A.N. 5254, 5255. The Second Circuit's interpretation of Section 546(e) is in accord with those goals. Giving effect to Section 546(e) here bolsters investor confidence by protecting brokerage customers from the possibility of having the proceeds of their market transactions clawed back years after the fact. Requiring good-faith market participants to scramble to find liquid funds for transactions long since completed threatens the very market confidence and stability that SIPA was meant to instill.

Petitioners' related argument that courts must give effect to SIPA by "read[ing] the stockbroker defense narrowly in SIPA cases" (Picard Pet. 25; *see also* SIPC Pet. 5, 32) is equally unavailing. Congress created one "stockbroker defense" (*see* Section 546(e)); it did not create different defenses for different settings. *Cf. RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2073 (2012) ("The Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law, and it is [a court's] obligation to interpret the Code clearly and predictably using well established principles of statutory construction."). Moreover, the suggestion that Section 546(e) means something different in the SIPA context ignores Congress's choice to bring within Section 546(e)'s safe harbor payments made by, to, or for the benefit of a stockbroker—a market participant whose insolvency will almost always trigger SIPA.

Furthermore, Congress knows how to make the Bankruptcy Code inapplicable in a SIPA proceeding. *E.g.*, 11 U.S.C. § 1501(c)(3) (excluding from cross-border bankruptcy jurisdiction "an entity subject to a proceeding under [SIPA]"). It simply chose not to do so here. The Second Circuit properly gave effect to Section 546(e)'s terms.

Picard's repeated claim that the Second Circuit's decision "gutted" SIPA (Picard Pet. 9, 10, 12) is unfounded—and contradicted by his own statements. Picard has announced that he has recovered over $10 billion in customer funds and distributed over $6.5 billion to Madoff Securities customers. *See* The Madoff Recovery Initiative, *A Message from SIPA Trustee Irving H. Picard*, http://www.madofftrustee.com/ (last visited May 14, 2015).

Moreover, the decision below recognizes that any actual fraudulent transfers made within two years of the SIPA liquidation filing are subject to avoidance. Pet. App. 12a, 29a. And Picard is aggressively pursuing claims, including against many respondents, to recover such transfers. Picard is also pursuing claims against other Madoff Securities customers who (unlike respondents) he alleges had actual knowledge of the fraud. *See Securities Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff Sec.)*, No. 12 MC 115 (JSR), 2013 U.S. Dist. LEXIS 56042, at *21-23, *29 (S.D.N.Y. Apr. 15, 2013). Those claims are unaffected by the decision below. *See id.* at *30 ("If the allegations adequately allege that a defendant had actual knowledge of Madoff's scheme, such a transferee stands in a different posture from an innocent transferee, even as concerns the application of Section 546(e)."). That reflects the balance Congress struck.

II. THE SECOND CIRCUIT'S DECISION BELOW DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT OR ANY OTHER COURT OF APPEALS

Petitioners have not identified any conflict of authority that warrants this Court's review. Picard argues that the decision below conflicts with this Court's decision in *Cunningham v. Brown*, 265 U.S. 1 (1924). Picard Pet. 10-11. There, the Court considered whether the defendants acted in bad faith when they withdrew funds from their accounts with Charles Ponzi, thus making the withdrawals avoidable. *See Cunningham*, 265 U.S. at 10. Because the record in that case established that the defendants withdrew the funds from their accounts *because of* Ponzi's insolvency, they could not escape the trustee's avoidance powers under the then-prevailing (and very different) avoidance provision of the former Bankruptcy Act. *Id.* at 11. Here, in contrast, it is conceded that respondents acted in good faith—*i.e.*, they were unaware of the fraud when the transfers were made, going back years before the fraud was publicly disclosed in 2008. *See* Pet. App. 46a n.9 ("[T]he Trustee does not allege that the defendants either knew of the fraud or should have known of it . . . ."). This case is nothing like *Cunningham*.[3]

Picard also argues that the decision below "conflict[s] in principle" with the decisions of other courts "that have denied the use of the stockbroker defense with respect to payments from Ponzi schemes." Picard Pet. 26-29. SIPC likewise argues that the decision below is in tension with other decisions addressing Ponzi schemes. SIPC Pet. 28, 31. But as Picard's "in principle" caveat implies, there is no *actual* conflict among the circuits. Indeed, both of the cases cited by Picard as creating a conflict turn on the "stockbroker" requirement. *See Johnson*, 525 F.3d at 819 ("We hold that Slatkin . . . was not a 'stockbroker.'"); *Wider*, 907 F.2d at 573 ("The debtor . . . is not a 'stockbroker' within the meaning of 11 U.S.C. § 546(e) . . . ."). But unlike in *Johnson* and *Wider,* petitioners here have *conceded* that Madoff Securities is a stockbroker. Pet. App. 14a.

SIPC suggests that the decision below is in tension with *Tolz v. Gawlick (In re Forex Fidelity International)*, 222 F. App'x 806, 808 (11th Cir. 2007). SIPC Pet. 28. But as SIPC itself acknowledges, the court of appeals in *Tolz* did not address Section 546(e)'s applicability to the transactions in that case. *Id.* Of course there can be no conflict with a decision that does not even address the question at issue.

Far from conflicting with the decisions of other circuits, the Second Circuit's interpretation is

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[3] In addition, the bankruptcy laws at the time of *Cunningham* had no provision remotely like Section 546(e). The decision below has to be evaluated in light of Section 546(e), not the statute in *Cunningham*.

consistent with the decisions of other circuits, which have regularly given effect to Section 546(e)'s broad terms. *E.g.*, *Grede v. FCStone, LLC*, 746 F.3d 244, 251-54 (7th Cir. 2014) (applying Section 546(e)'s "deliberately broad" text to shield from claw back "settlement payments" made "'in connection with a securities contract'"); *In re Derivium*, 716 F.3d at 366 (rejecting argument that there should be an "exception" to Section 546(e) for Ponzi schemes); *Brandt v. B.A. Capital Co. (In re Plassein Int'l Corp.)*, 590 F.3d 252, 257-59 (3d Cir. 2009) (relying on "plain language" to insulate leveraged buyout payments to shareholders as "settlement payments," even when the stockbroker involved was a mere conduit for the payments), *cert. denied*, 559 U.S. 1093 (2010); *In re QSI Holdings, Inc.*, 571 F.3d at 549-50 (recognizing that the definition of "settlement payment" is "extremely broad").

In *Contemporary Industries Corp. v. Frost*, 564 F.3d 981, 986 (8th Cir. 2009), for example, the Eighth Circuit, like the Second Circuit below, concluded that the definition of "settlement payment" in Section 741(8) "was intended to sweep broadly" and thus "encompasses most transfers of money or securities made to complete a securities transaction." Likewise, the Ninth Circuit recognized that the term settlement payment is "broadly define[d]" to include those steps that are part of the process of settling. *Jonas*, 971 F.2d at 326. And as the Second Circuit concluded below, even if all steps in the process were not completed, the payments here surely were part of the process of settling the transactions the customers set into motion with their withdrawal requests. Pet. App. 27a.

Other cases cited by petitioners are inapposite. The Third Circuit's decision in *Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Savings & Loan Ass'n*, 878 F.2d 742, 744, 751-53 (3d Cir. 1989), for example, focused on what constituted a settlement payment within the unique nature of the federal government's securities repurchase market, and found that the transfer in question *was* a settlement payment. *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527 (B.A.P. 9th Cir. 2005), also addressed a question not presented here—whether settlement payments include payments derived from "illegally unregistered" securities in *non-public* transactions—and therefore is inapposite. Moreover, to be clear, *Kipperman* is not a decision of the Ninth Circuit; it is a decision of three bankruptcy judges serving on that circuit's Bankruptcy Appellate Panel.

III. PETITIONERS' BROAD-BASED ATTACKS ON "PONZI SCHEMES" PROVIDE NO BASIS FOR CERTIORARI

Petitioners' request that this Court decide "whether section 546(e) applies, as here, to Ponzi scheme transfers," SIPC Pet. 32; Picard Pet. 10, also misses the mark. What petitioners want is a judicially made "Ponzi scheme exception" to a statute—Section 546(e)—that already contains an exception for actual fraudulent transfers. *See* 11 U.S.C. § 546(e); 11 U.S.C. § 548(a)(1)(A). But "[w]here Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied." *Andrus v. Glover Constr. Co.*, 446 U.S. 608, 616-17 (1980).

Whether Section 546(e) applies to a transfer by a brokerage firm engaged in a so-called Ponzi scheme turns not on the existence of a Ponzi scheme (however that term is defined) but instead on whether the requirements of Section 546(e) are satisfied. In addition to the Second Circuit, two other circuits have rejected analogous attempts to read additional exceptions into Section 546(e). None has held otherwise. *See Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 749 (7th Cir. 2013) ("If the Trustee were right that § 546(e) is irrelevant when the debtor in bankruptcy had any role in a fraud, why did Congress add the exception referring to § 548(a)(1)(A)? The presence of an exception for actual fraud makes sense only if § 546(e) applies as far as its language goes."); *In re Derivium Capital LLC*, 716 F.3d at 366 (Plaintiff "fails to convince us we need to establish an extra-statutory fraud exception [for Ponzi schemes] to the stockbroker defense."). In other words, petitioners' focus on "Ponzi schemes" is just another attempt to deflect attention from the statutory text.

Petitioners insistence that Section 546(e)'s protections should be suspended if the stockbroker engaged in a Ponzi scheme or if the level of "systemic disruption" fails to reach some undefined level is an invitation to judicial chaos and uncertainty. It would embroil the courts in complex, expensive, and wasteful factual discovery and litigation into whether any given fraud was sufficiently pervasive to be a "Ponzi scheme" (a term not defined in the Bankruptcy Code or SIPA). Similar inquiries would need to be made about whether unwinding the transactions would create sufficient "systemic disruption" to qualify—another concept not found in any of the statutory words.

Moreover, this case would be an inapt vehicle to consider any broader questions concerning the application of Section 546(e) to "Ponzi schemes." Unlike most cases involving Ponzi schemes, the fraudster in this case (Madoff Securities) undeniably qualified as a stockbroker under the Bankruptcy Code. Whether the fraudster qualifies as a "stockbroker" is usually the focal point in evaluating whether transfers made in connection with a Ponzi scheme are avoidable. *See, e.g.*, *Johnson*, 525 F.3d at 816.

Additionally, respondents here—customers of a registered stockbroker—are conceded to have acted in good faith. *See* Pet. App. 46a n.9 ("the Trustee does not allege that the defendants either knew or should have known of [the fraud]"). Any questions as to whether a SIPA trustee may recoup payments from customers who are allegedly *complicit* in or *know of* the fraud, or from customers who deliberately structured their transactions to obtain a larger share of funds before the broker's collapse, are not presented by this case.

Amici's "fairness" objections also provide no basis for granting review. *See generally* Br. of Amici Curiae Academics 1; Br. of Amici Curiae "Net Loser" Customers 7-8. Fairness was a question *for Congress* in deciding how to strike the balance among competing considerations, including the need for finality in the marketplace; it is not a question for this Court in interpreting the statute that Congress enacted. *Grede*, 746 F.3d at 254 (applying Section 546(e); "[C]ourts may not decline to follow [policy choices made by Congress] on equitable grounds, however powerful they may be in a particular case." (citation omitted)); *Peterson*, 729 F.3d at 749 ("The Trustee is not asking us to choose sides in a debate about interpretive method so much as he is asking us to chuck § 546(e) out the window. . . .

The text is what it is and must be applied whether or not the result seems equitable.”).

In any event, whether the decision below is fair or unfair to any particular party depends on one’s vantage point. For example, a Madoff Securities customer who was completely unaware of Madoff’s scheme and who, in 2004, withdrew money from her account to pay for a child’s college education or a new roof would hardly agree that it is fair to claw back those funds from the customer a decade or so later. And there are thousands of variations of that hypothetical on the customer side.[4]

Petitioners’ policy-based attacks on the decision below are also misplaced. *See* Picard Pet. 25-26; SIPC Pet. 13-14, 27; *see also* Br. of Amici Curiae Academics 19-21. Concerns about the statute’s breadth are properly presented to Congress, not this Court. As the district court noted, “Section 546(e) has been revisited by Congress on numerous occasions, as recently as 2006, when it was amended to its present wording.” Add. 16a n.3. “If Congress did not mean it to be taken literally, Congress had ample opportunity to narrow or alter the wording, but Congress chose not to.” *Id.* The Second Circuit properly declined petitioners’ invitation to upset the balance that Congress struck in weighing the “complex competing considerations” (Pet. App.

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[4] It is little comfort that the Trustee claims the authority to grant “hardship” exemptions, because those exemptions are subject to his sole, unreviewable discretion. The Madoff Recovery Initiative, *Hardship Program*, http://www.madofftrustee.com/hardship-program-17.html (last visited May 14, 2015).

29a) underlying the decision whether to avoid the securities-related transfers at issue.

There is no basis for this Court to do otherwise.

CONCLUSION

The petitions for writs of certiorari should be denied.

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ADDENDUM

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UNITED STATES DISTRICT COURT,
S.D. NEW YORK.

Irving H. PICARD, Plaintiff,

v.

Saul B. KATZ, et al., Defendants.

No. 11 Civ. 3605 (JSR).
Adversary No. 10–05287.

Sept. 27, 2011.

462 B.R. 447

OPINION AND ORDER

JED S. RAKOFF, District Judge.

Pending before the Court is the motion of defendants Saul B. Katz, et al., made pursuant to Fed. R. Bankr.P. 7012(b) and Fed.R.Civ.P. 12(b)(6), to dismiss the Amended Complaint filed against them on March 18, 2011, by Irving H. Picard (the "Trustee"), who was appointed under the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§ 78aaa et seq., to liquidate the business of Bernard L. Madoff and Bernard L. Madoff Investment Securities LLC ("Madoff Securities").[1] In a "short and plain

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1 This adversary proceeding was originally filed in Bankruptcy Court under the docket number 10–05287, assigned to the Hon. Burton R. Lifland as part of the SIPA Liquidation entitled Securities Investor Protection Corporation v. Bernard L. Madoff Investment Securities LLC, 08–01789(BRL). The reference of this adversary proceeding to the Bankruptcy Court was subsequently withdrawn, and the lawsuit, assigned the number 11 Civ. 3605(JSR), is now before this Court through the conclusion of trial.

statement"[2] of 373 pages, the Amended Complaint seeks to recover over a billion dollars from the defendants on theories of actual fraud, constructive fraud, preferential transfer, and the like, in violation of various provisions of federal bankruptcy law and New York State debtor and creditor law. For the following reasons, the Court dismisses all claims except those alleging actual fraud and equitable subordination and narrows the standard for recovery under the remaining claims.

Although this lawsuit raises important and in some respects unsettled issues of the interaction of securities law with bankruptcy law, given the public interest in this case it is well to begin with the basics. A debtor with assets less than its obligations is considered insolvent in the eyes of the law and may apply for, or be forced into, bankruptcy. *See generally*, Bankruptcy Code, 11 U.S.C. §§ 101 et seq. Issues then arise regarding whether prior payments made by the debtor can be, in effect, rescinded—or, in the language of bankruptcy law, "avoided"—and the money returned ("clawed back") to the bankrupt's estate, from where it can be distributed among creditors in accordance with legal and equitable principles of bankruptcy law.

Some of the avoided payments may take the form of "preferences." If, prior to the bankruptcy filing, the bankrupt transfers some or all of its remaining assets to some of its creditors in preference to the other creditors, this transfer, known as a "preference," may be "avoided"—regardless of the facial validity of the

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2 *See* Fed.R.Civ.P. 8(a), made applicable to complaints filed in bankruptcy adversary proceedings by Fed. R. Bankr.P. 7008.

transfer or the intent of the parties to the transfer—if it occurred within 90 days of the filing for bankruptcy. *See* 11 U.S.C. § 547(b). The idea is that, while an ongoing business may freely decide which of its creditors to pay first, an insolvent business cannot be allowed to deplete its remaining assets in favor of one creditor over another.

Other avoided payments may take the form of "fraudulent transfers." For example, if an insolvent debtor intentionally seeks to defraud his creditors—as when a debtor who has a huge judgment filed against him intentionally seeks to hinder recovery by transferring all of his assets to a friend—the transfer can be avoided as an actually fraudulent transfer. *See* 11 U.S.C. § 548(a)(1)(A). Still other transfers can be avoided as "constructively fraudulent," *i.e.*, as fraudulent in effect, even if not in intent. Thus, if the insolvent debtor, regardless of intent, transfers his remaining assets to his friend in return for plainly inadequate consideration, that transfer can be avoided as "constructively fraudulent." *See* 11 U.S.C. § 548(a)(1)(B).

Under the Bankruptcy Code, fraudulent transfers (whether actual or constructive) can be avoided if they occurred within 2 years of the bankruptcy filing. 11 U.S.C. § 548(a)(1). But the Bankruptcy Code also adopts for these purposes the "applicable [state] law," *see* 11 U.S.C. § 544(b)—which means in this case New York Debtor and Creditor Law, under which fraudulent transfers can be avoided if they occurred within 6 years of the filing. *See* N.Y. C.P.L.R. § 213(8).

In the case of the bankruptcy of Madoff Securities, however, these basic principles are affected by several special features. First, Madoff Securities was a registered securities brokerage firm, a fact that directly invokes certain "safe harbor" provisions of the Bankruptcy Code, permits the appointment of a SIPA Trustee, and indirectly implicates certain principles of the securities laws. Second, Madoff and Madoff Securities were, at all times here relevant, engaged in the special kind of fraud known as a "Ponzi scheme," by which customers of Madoff Securities, who were led to believe that their monies were being invested in profitable securities transactions, were paid their profits from new monies received from customers, without any actual securities trades taking place.

Because Madoff Securities was a registered stockbrokerage firm, the liabilities of customers like the defendants here are subject to the "safe harbor" set forth in section 546(e) of the Bankruptcy Code. "By restricting a bankruptcy trustee's power to recover payments that are otherwise avoidable under the Bankruptcy Code, the safe harbor stands 'at the intersection of two important national legislative policies on a collision course—the policies of bankruptcy and securities law.'" *In re Enron Creditors Recovery Corp.*, 651 F.3d 329, 334 (2d Cir.2011) (quoting *In Re Resorts Int'l, Inc.*, 181 F.3d 505, 515 (3d Cir.1999)). Specifically, section 546(e) of the Bankruptcy Code provides that "[n]otwithstanding sections 544, 545, 547, 548(a)(1)(B) and 548(b) of this title [*i.e.*, all the sections dealing with preferences and constructive fraud under the Bankruptcy Code and, by reference, all applicable sections of New York State law], the trustee may *not* avoid a transfer that is a . . . settlement payment, as defined in section . . . 741 of this title, made *by* or *to* (or for the benefit of) a . . . stockbroker . . . or that is a transfer made *by* or *to* (or for the benefit of) a . . . stockbroker, in connection with a securities contract, as defined in section 741(7) . . . *except* under section 548(a)(1)(A) of this title [dealing with actual fraud]." 11 U.S.C. § 546(e) (emphasis supplied). Section 741(7) defines a "securities contract" as a "contract for the purchase, sale, or loan of a security," which is the kind of contract Madoff Securities had with its customers. Section 741(8) defines "settlement payment" as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade"—an "extremely broad" definition, *see Enron*, at 334 (collecting cases), which clearly includes all payments made by Madoff Securities to its customers. Furthermore, any payment by Madoff Securities to its customers that somehow does not qualify as a "settlement payment" qualifies as a "transfer" made "in connection with a securities contract." By its literal language, therefore, the Bankruptcy Code precludes the Trustee from bringing any action to recover from any of Madoff's customers any of the monies paid by Madoff Securities to those customers except in the case of actual fraud.

Notwithstanding the plain language of section 546(e), the Trustee argues that it should not be applied here, because doing so would (supposedly) not accord with the statute's purpose. Congress enacted § 546(e) "to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." *In re Manhattan Inv. Fund Ltd.*, 310 B.R. 500, 513 (Bankr.S.D.N.Y.2002) (quoting H.R.Rep. No. 97–420

(1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583). Although the Trustee argues that avoiding Madoff Securities' transfers to customers cannot cause the "displacement" that § 546(e) aims to prevent, this seems at variance with his own Amended Complaint, which alleges that the Madoff fraud involved approximately $68 billion and 4,900 customers. *See* Amended Complaint ¶ 39. As in *Enron*, this Court sees "no reason to think that undoing" such large transfers involving so many customers from so long ago as 2002 "would not also have a substantial and similarly negative effect on the financial markets." *Enron*, 651 F.3d at 338.

In any event, resort to legislative history is inappropriate where, as here, the language of the statute is plain and controlling on its face. "[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253–54, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992). Indeed, to deviate from what Congress has clearly and constitutionally decreed is a power the judiciary does not possess. *See Lamie v. U.S. Trustee*, 540 U.S. 526, 534, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004). Thus, here, as in Enron, there is neither a need nor a basis "to address . . . arguments regarding [the] legislative history [of § 546(e)]." *Enron*, 651 F.3d at 338.[3]

[3] While the Trustee also argues the section 546(e) was designed to protect only stockbrokers, not customers, this, again, is nowhere indicated on the face of the statute. From the standpoint of Madoff Securities' customers (except for any who were actual participants in the fraud), the settlement payments made to them by Madoff Securities were entirely bona fide, and they therefore

Accordingly, the Court grants the defendants' motion to dismiss all claims predicated on principles of preference or constructive fraud under the Bankruptcy Code, as well as all claims under New York law, collectively corresponding to Counts 2 through 9 of the Amended Complaint.

This leaves, principally, the Trustee's claim for actual fraud under § 548(a)(1)(A) of the Bankruptcy Code (Count 1 of the Amended Complaint).[4] Section 548(a)(1)(A) permits the Trustee to avoid any payment made by Madoff Securities to its customers within two years of the filing of the bankruptcy petition if the debtor (Madoff Securities) "made such transfer . . . with actual intent to hinder, delay, or defraud any entity to which the debtor was or became . . . indebted." Since it is undisputed that Madoff's Ponzi scheme began more than two years before the filing of the bankruptcy petition and continued to almost the

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are fully entitled to invoke the protections of section 546(e). Indeed, were it otherwise, the very uncertainty that the Trustee says the statute was designed to obviate would prevail. In any event, there is no reason to ignore the breadth of the statutory language. Section 546(e) has been revisited by Congress on numerous occasions, as recently as 2006, when it was amended to its present wording. *See* Financial Netting Improvements Act of 2006, Pub.L. No. 109–390, § 5, 120 Stat. 2692, 2697–98 (2006) (inserting "or for the benefit of" and "in connection with a securities contract," and thereby broadening the statute's application). If Congress did not mean it to be taken literally, Congress had ample opportunity to narrow or alter the wording, but Congress chose not to.

4 The Trustee's other two claims not barred by section 546(e), for disallowance and subordination of the defendants' own claims (Counts 10 and 11 of the Amended Complaint), are discussed below.

very day of filing, it is patent that all of Madoff Securities' transfers during the two-year period were made with actual intent to defraud present and future creditors, *i.e.*, those left holding the bag when the scheme was uncovered.[5] Nonetheless, subsection (c) of section 548 provides that "a transferee or obligee of such a transfer or obligation that takes *for value and in good faith* ... may retain such any interest transferred or may enforce any obligation incurred, as the case may be, *to the extent that such transferee or obligee gave value* to the debtor in exchange for such transfer or obligation." 11 U.S.C. § 548(c) (emphasis supplied). It is clear that the principal invested by any of Madoff's customers "gave value to the debtor," and therefore may not be recovered by the Trustee absent bad faith. As for transfers made by Madoff Securities to its customers in excess of the customers' principal—that is, the customers' profits—these were in excess of the "extent" to which the customers gave value, and hence, if adequately proven, may be recovered regardless of the customers' good faith.

The defendants attempt to resist this latter conclusion, arguing that, as long as they acted in good faith, their profits, as reflected in Madoff Securities'

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[5] On the facts of this case as alleged in the Amended Complaint (which for purposes of this motion must be taken as true), there is therefore no need to invoke any "Ponzi scheme presumption." *See, e.g., SEC v. Res. Dev. Int'l, LLC*, 487 F.3d 295, 301 (5th Cir.2007) ("In this circuit, proving that IERC operated as a Ponzi scheme establishes the fraudulent intent behind the transfers it made."); *In re Agric. Research & Tech. Grp.*, 916 F.2d 528, 535 (9th Cir.1990) ("[T]he debtor's actual intent to hinder, delay or defraud its creditors may be inferred from the mere existence of a Ponzi scheme.").

monthly statements to them purporting to reflect actual securities trades, were legally binding obligations of Madoff Securities, so that any payments of those profits to the customers were simply discharges of antecedent debts. In this regard, the defendants rely heavily on *In re Sharp Int'l Corp.*, which held that a "conveyance which satisfies an antecedent debt made while the debtor is insolvent is neither fraudulent nor otherwise improper, even if its effect is to prefer one creditor over another." 403 F.3d 43, 54 (2d Cir.2005) (quoting *Ultramar Energy Ltd. v. Chase Manhattan Bank, N.A.*, 191 A.D.2d 86, 90–91, 599 N.Y.S.2d 816 (1st Dep't 1993)). *Sharp*, however, did not apply this holding to actually fraudulent transfers. Instead, it found that the attempts to avoid actually fraudulent transfers failed "for the independent reason that Sharp inadequately allege[d] fraud." *Id.* at 56. Here, the allegations of the Amended Complaint clearly make out a claim that all of the transfers made by Madoff Securities in the two years prior to the filing of the bankruptcy petition were made with the intent on the part of Madoff Securities to "hinder, delay, or defraud" past and future customers, so that a prima facie case of actual fraud under section 548(a)(1)(A) has been adequately pled. Whether, in these circumstances, defendants can avail themselves of the affirmative defense of taking for value and in good faith under section 548(c) is in no way controlled by *Sharp*. *See, e.g.*, *In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 11 (S.D.N.Y.2007) ("At most, [*Sharp*] simply means that courts must be sure that the transfers sought to be avoided are related to the [Ponzi] scheme.").

In other words, while, as to payments received by the defendants from Madoff Securities equal to a return of their principal defendants can defeat the Trustee's claim of actual fraud simply by proving their good faith, as to payments received by the defendants in excess of their principal defendants can defeat the Trustee's claim of actual fraud only by showing that they not only were proceeding in good faith but also that they took for value.[6]

It remains only to define what is meant by lack of "good faith" in this context. Both sides agree that if the defendants had actual knowledge of Madoff's scheme, it would constitute lack of good faith. But even the Trustee does not appear to undertake the dubious task of plausibly pleading that the defendants knowingly invested in a Ponzi scheme. Both sides also agree, however, that if the defendants willfully blinded themselves to the fact that Madoff Securities was involved in some kind of fraud, this too might,

[6] Although, given the difficulty defendants will have in establishing that they took their net profits for value, the Trustee might well prevail on summary judgment seeking recovery of the profits, how to determine which profits the Trustee can recover remains an open question. Specifically, the Court does not resolve on this motion whether the Trustee can avoid as profits only what defendants received in excess of their investment during the two year look back period specified by section 548 or instead the excess they received over the course of their investment with Madoff. According to the Amended Complaint, defendants' profits amounted to $83,309,162 in the two years preceding the bankruptcy and $295,465,565 over the course of their investment. Amended Complaint ¶¶ 1105, 1108.

depending on the facts, constitute a lack of good faith.[7] The Amended Complaint plainly advances this theory of willful blindness. *See, e.g.*, Amended Complaint ¶ 9 ("Given Sterling's dependency on Madoff, it comes as no surprise that the Sterling partners willfully turned a blind eye to every objective indicia of fraud before them."). But why would defendants willfully blind themselves to the fact that they had invested in a fraudulent enterprise? The Amended Complaint alleges, in effect, that it was because they felt they could realize substantial short-term profits while protecting themselves against the long-term risk. Although the defendants vehemently deny these accusations,[8] the Amended Complaint, while less than overwhelming in this regard, pleads sufficient allegations to survive a motion to dismiss so far as this claim of willful blindness is concerned. *See, e.g.*, Amended Complaint ¶¶ 702–710, 941–948 (defendants seriously considered purchasing fraud insurance with respect to their investments in Madoff Securities and

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7 For the purposes of this motion, but not necessarily otherwise, the Court finds, based on the allegations of the Amended Complaint at, *e.g.*, ¶¶ 659, 853–864, that the defendants' investment decisions were sufficiently coordinated that the intent of their common vehicle, Sterling Equities, and its principals, can be imputed to the other defendants. *See Baker v. Latham Sparrowbush Assocs.*, 72 F.3d 246, 255 (2d Cir.1995); *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1089 n. 3 (2d Cir.1972).

8 The details of these denials are largely set forth as part of defendants' request that the Court convert their motion to dismiss into a motion for summary judgment. Finding that the Trustee has made a reasonable argument that he is entitled to further discovery before a motion for summary judgment is fully ripe, the Court declines defendants' invitation to convert.

created their own hedge fund in 2002 at least partly to limit their exposure in Madoff Securities).

Perhaps recognizing the problems with this approach, however, the Trustee falls back on arguing that, alternatively, defendants were on "inquiry notice" of the fraud but failed to diligently investigate Madoff Securities and that this also constitutes lack of good faith. *See In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 22–23 (S.D.N.Y.2007). Defendants, for their part, strenuously contest that this theory is applicable in the instant setting.

The difference between the inquiry notice approach and the willful blindness approach is essentially the difference between an objective standard and a subjective standard. Under the former approach, a transferee has inquiry notice when the "information [the transferee] learned would have caused a reasonable [person] in [the transferee's] position 'to investigate the matter further.' " *Manhattan*, 397 B.R. at 23 (quoting *Nat'l W. Life Ins. Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 89 Fed.Appx. 287, 291 (2d Cir.2004)). In such circumstances, a failure to further investigate constitutes lack of good faith unless even diligent inquiry would not have unearthed the fraud. *See In re Agric. Res. & Tech Grp.*, 916 F.2d 528, 536 (9th Cir.1990).

Although this approach is not without some precedent in ordinary bankruptcies, it has much less applicability, the Court concludes, in a context of a SIPA trusteeship, where bankruptcy law is informed by federal securities law. Just as fraud, in the context of federal securities law, demands proof of scienter, so too "good faith" in this context implies a lack of fraudulent intent. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 215, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976) (holding that scienter requires "proof of more than negligent nonfeasance"). A securities investor has no inherent duty to inquire about his stockbroker, and SIPA creates no such duty. *See generally In re New Times Sec. Servs.*, 371 F.3d 68, 87 (2d Cir.2004). If an investor, nonetheless, intentionally chooses to blind himself to the "red flags" that suggest a high probability of fraud, his "willful blindness" to the truth is tantamount to a lack of good faith. *See United States v. Rodriguez,* 983 F.2d 455, 458 (2d Cir.1993) ("conscious avoidance," another term for willful blindness, means "that the defendant was aware of a high probability of the fact in dispute and consciously avoided confirming that fact"). But if, simply confronted with suspicious circumstances, he fails to launch an investigation of his broker's internal practices—and how could he do so anyway?—his lack of due diligence cannot be equated with a lack of good faith, at least so far as section 548(c) is concerned as applied in the context of a SIPA trusteeship.

In short, the Court concludes that, as to the claim of actual fraud (Count 1), the Trustee can recover defendants' net profits over the two years prior to bankruptcy simply by showing that the defendants failed to provide value for those transfers, but the Trustee can recover the defendants' return of principal during that same period only by showing an absence of good faith on defendants' part based on their willful blindness.[9]

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[9] While the burden of raising the defense of good faith is initially on the defendants, the question of whether, once the

Turning to the remaining claims, the Trustee seeks to disallow the defendants' own claims made on Madoff Securities' estate (Count 10) or at least to equitably subordinate them to other customers' claims (Count 11). As to disallowance, here again there is a conflict between the policies of the bankruptcy laws in general and of the securities laws, in this case expressed through SIPA. Thus, while section 502(d) of the Bankruptcy Code would support disallowance of the claims made against a bankruptcy estate by a party who received transfers that were void or voidable, this section is overridden in the context of a SIPA trusteeship by Section 78fff–2 of SIPA, which provides that securities customers who have received avoidable transfers may still seek to pursue those transfers as creditors of the SIPA estate. 15 U.S.C. § 78fff–2(c)(3). The point, once again, is to provide stability in the securities markets by imparting a greater degree of certainty to securities transactions than to other kinds of transactions. Accordingly, Count 10 must be dismissed.

It does not follow, however, that because a securities customer pursuing allegedly voidable claims is not wholly barred from pursuing them in a SIPA liquidation, the claims still stand on the same footing as all other claims. Under § 510(c) of the Bankruptcy Code, "the court may . . . under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim." Courts equitably subordinate claims when the claimant has "engaged in

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defendants have made a prima facie showing of good faith, the burden shifts back to the Trustee to show lack of good faith, is an issue that need not be decided on this motion.

some type of inequitable conduct" and the "misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant." *In re Mobile Steel Co.*, 563 F.2d 692, 700 (5th Cir.1977). Inequitable conduct "encompasses conduct that may be lawful but is nevertheless contrary to equity and good conscience." *In re Verestar, Inc.*, 343 B.R. 444, 461 (Bankr.S.D.N.Y.2006). Because the Amended Complaint adequately alleges that the defendants did not receive fraudulent transfers in good faith, it also adequately alleges that they engaged in inequitable conduct. Moreover, this alleged misconduct would have injured any investors who invested in Madoff Securities based on the impressive returns others appeared to receive. Thus, while the Trustee cannot disallow the defendants' claims against the Madoff Securities' estate, he can potentially subordinate them by proving that the defendants invested with Madoff Securities with knowledge, or in reckless disregard, of its fraud.

In summary, the Court hereby dismisses all Counts of the Amended Complaint except Counts 1 and 11. Under Count 1, the Trustee may recover defendants' net profits simply by proving that the defendants did not provide value for the monies received, but the Trustee may recover the return of the defendants' principal only by proving that the defendants willfully blinded themselves to Madoff Securities' fraud. Finally, the Trustee can subordinate the defendants' own claims against the estate only by making the same showing required under Count 1 or its equitable equivalent.

The parties are directed to appear in court tomorrow, September 28, 2011 at 3:00 P.M. to set a schedule for all further proceedings relating to the remaining claims.

SO ORDERED.