UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IRVING H. PICARD, Plaintiff, - against - SAUL B. KATZ, et al., Defendants.	:	11-CV-03605 (JSR) (HBP)

MEMORANDUM OF LAW IN OPPOSITION TO TRUSTEE'S MOTION FOR PARTIAL SUMMARY JUDGMENT

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Defendants respectfully submit this memorandum of law in opposition to the Trustee's motion for partial summary judgment. All transfers to Defendants were "for value." The Trustee's motion must be denied.

PRELIMINARY STATEMENT

The Trustee has moved for partial summary judgment with regard to transfers of "profits." He argues that "Defendants cannot establish that they took the transfers of fictitious profits 'for value' because the profits were not on account of a valid antecedent debt." But his legal argument ignores three critical factors, none of which is in dispute. First, BLMIS was a registered broker. Second, Article 8 of the New York Uniform Commercial Code ("UCC") establishes that a broker is liable to a customer for the securities reflected on the statements issued by the broker. And, third, the Trustee cannot avoid BLMIS' obligations to Defendants. Therefore, all payments by BLMIS to Defendants satisfied such obligations and were, by definition, "for value," under 11 U.S.C. § 548(d)(2). In addition, as set forth in Defendants' motion for summary judgment, the undisputed evidence demonstrates that no Defendant was willfully blind to Madoff's fraud.

ARGUMENT

BLMIS was obligated to each Defendant for the blue chip securities and Treasuries on his, her, or its account statement pursuant to Article 8 of the UCC, and its obligation was enforceable under several bodies of law. These obligations establish "value" for all transfers on account of such obligations. Although this Court has suggested that Defendants will have difficulty establishing that they took profits "for value," *see Picard v. Katz*, 11 Civ. 3605, 2011 U.S. Dist. LEXIS 109595, at *14-18 & n.6

(S.D.N.Y. Sept. 27, 2011), Defendants respectfully submit that BLMIS' status as a broker, Defendants' status as creditors, and UCC Article 8 mandate that all transfers were for value.[1]

The Ponzi scheme cases relied upon by the Trustee are not to the contrary. The existence of a Ponzi scheme is used in these cases as the basis for a finding of fraudulent intent on the part of the transferor, but this finding does not affect the recognition that creditor claims constitute "value" for avoidance purposes. The cases cited by the Trustee differ from this case only as to the nature of the claims at issue. Those cases afford restitution claims to defrauded *equity investors*. In this case, Defendants were *creditors* whose claims were not limited to restitution, requiring the conclusion that all payments to Defendants by BLMIS were "for value" within the meaning of 11 U.S.C. § 548(d)(2).

I. ALL TRANSFERS WERE "FOR VALUE"

A. Each Defendant Had Valid Claims Against BLMIS Under Article 8 and Other State Law

The Second Circuit has ruled that each claimant who deposited cash with BLMIS "for the purpose of purchasing securities" should be "treated as a customer with claims

[1] Defendants do not dispute, and have offered to stipulate to, the only facts relevant to this motion—the dates, amounts, and account holder recipients of cash transfers. Nevertheless, the Trustee has filed a lengthy, and largely improper, purported statement of undisputed material facts pursuant to Rule 56.1(a) of the Local Civil Rules ("Trustee's Rule 56.1 Statement"). *See* Trustee's Statement of Undisputed Material Facts Pursuant to Local Rule 56.1, *Picard v. Katz*, 11 Civ. 3605, doc. no. 102 (S.D.N.Y. Jan. 26, 2012). The Trustee's Rule 56.1 Statement is replete with expert opinions, legal conclusions, and "facts" that have no bearing on this motion. Further, in their prior briefs, Defendants have challenged the Trustee's methodology for calculating "principal" and "profit" and, therefore, disagree with the Trustee's assertion that the "Two-Year Net Winner Defendants" received, in the aggregate, $83 million of "profits." (Trustee's Mem. of Law in Supp. of Mot. for Partial Summ. J. ("Tr. Mem.") at 1 n.1, 23-25.)

for securities." *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 236 (2d Cir. 2011) (internal quotation marks omitted). This Court's decision that transfers from BLMIS to customers were, as a matter of law, settlement payments and/or transfers made in connection with a securities contract implicitly reaches the same conclusion. *Katz*, 2011 U.S. Dist. LEXIS 109595, at *9-14. The Trustee and SIPC do not disagree.

> "All BLMIS customers who filed claims—whether their net equity customer claims were allowed or denied—are general creditors of the BLMIS estate. The Trustee is working diligently on behalf of the entire BLMIS estate and seeks to satisfy all creditor claims in this proceeding." Trustee's Sixth Interim Report for the Period Ending September 30, 2011, *In re Bernard L. Madoff Inv. Sec. LLC*, 08-1789, doc. no. 4529, at 35 (Bankr. S.D.N.Y. Nov. 15, 2011).

> "[T]o the extent that the Claimants in this case have been harmed by the Debtor by more than the net amounts deposited by them, their claims are for damages which are general creditor, and not customer, claims. This is the true nature of their claims, but as to such losses, investors are not protected by SIPA." Brief of Appellee SIPC, *In re Bernard L. Madoff Inv. Sec. LLC*, 10-2378-bk, doc. no. 282, at 52 (2d Cir. Sept. 20, 2010).

These creditor claims arise under UCC Article 8 and are enforced principally pursuant to state contract law. Under Article 8, a securities entitlement arose in favor of each Defendant when BLMIS issued a statement or confirmation evidencing ownership of securities. UCC § 8-501. Defendants became creditors with "claims" against BLMIS for securities, and BLMIS owed them concomitant "debts." At any time prior to BLMIS' SIPA filing, a Defendant could have obtained a judgment under Article 8 enforcing those debts. Article 8 does not distinguish between "principal" and "profits"—the amount of a broker's obligation to its customer is determined by reference to the account statements delivered by the broker to the customer. And the fact that the broker may have been engaged in fraud does not affect the customer's legal rights.

> "In the indirect holding system, the significant fact is that the securities intermediary has undertaken to treat the customer as entitled to the financial asset. It is up to the securities intermediary to take the necessary steps to ensure that it will be able to perform its undertaking. . . . The entitlement holder's rights against the securities intermediary do not depend on whether or when the securities intermediary acquired its interests. . . . The duty of a securities intermediary to maintain sufficient assets is governed by 8-504 and regulatory law. Subsection (c) [of Section 8-501] is included only to make it clear the question whether a person has acquired a security entitlement does not depend on whether the intermediary has complied with that duty." UCC § 8-501 cmt. 3.

The word "broker" does not appear in the Trustee's brief in support of his motion for partial summary judgment, which also makes no mention of Article 8. But the Trustee has recognized customer claims against BLMIS under other bodies of law.

> "All BLMIS creditors, including customers whose claims were allowed, customers whose claims were denied, and general creditors, may have claims as general creditors against BLMIS for *misrepresentation, fraud, and breach of contract* . . . ." (Mot. for an Order Approving an Initial Allocation of Property to the Fund of Customer Property and Authorizing an Interim Distribution to Customers, *In re Bernard L. Madoff Inv. Sec. LLC*, No. 08-01789, doc. no. 4048, at 11 n.9 (Bankr. S.D.N.Y. May 4, 2011) (emphasis added).)

Thus, even the Trustee acknowledges that a broker who fails to invest funds deposited for investment is liable for breach of contract. The remedy for breach of contract is not limited to restitution.[2] On the contrary, a customer would be entitled to

[2] Even a restitution claim would include a recovery for the time value of money. *See NML Capital v. Republic of Argentina*, 17 N.Y.3d 250, 266 (2011). ("[P]laintiffs are entitled to be compensated for the loss of the time value of that money—which can be accomplished only by awarding them statutory interest on the unpaid interest-only payments.") And the SEC has advocated for a constant dollar approach rather than a limited restitution remedy. Brief of the SEC, Amicus Curiae, in Supp. of Appellee and Affirmance of the Order of the Bankruptcy Court, *In re Bernard L. Madoff Inv. Sec. LLC*, 10-2378-bk, doc. no. 296, at 4, 17 (2d Cir. Sept. 21, 2010).

"benefit of the bargain damages"—what the customer would have owned had the securities been acquired as promised—if his broker failed to acquire securities.

> "Plaintiffs gave $21 million to [the broker], not to hide under a rock or lock in a safe, but for the express purpose of investment, with a hope—indeed a reasonable expectation—that it would grow. Thus, the out-of-pocket theory, which seeks to restore to Plaintiffs only the $21 million they originally invested less their subsequent withdrawals, is a wholly inadequate measure of damages. Had [the broker] invested Plaintiffs' money as requested, their funds would have likely grown immensely. . . . In fact, the fictitious statements issued by Lehman, which were designed to track Plaintiffs' funds as if they had been properly invested, indicate that Plaintiffs' accounts would have grown to more than $37.9 million. . . . Plaintiffs thus . . . were entitled to the full $37.9 million balance shown, regardless of the amounts of their previous deposits and withdrawals." *Visconsi v. Lehman Bros.*, 244 F. App'x 708, 713-14 (6th Cir. 2007).

B. Each Defendant's Claims Against BLMIS Constituted "Value" Under 11 U.S.C. § 548(d)(2)

Customer claims under Article 8 and contract law constitute "value." "Value" is defined in the Bankruptcy Code as "satisfaction . . . of a present or antecedent debt." 11 U.S.C. § 548(d)(2)(A). "Debt" is defined as "liability on a claim." *Id.* § 101(12). "Claim" is defined extremely broadly as a "right to payment." *Id.* § 101(5)(A). And a creditor is an "entity that has a claim against the debtor." *Id.* § 101(10)(A).

The Trustee does not dispute that a claim constitutes "value" or that Defendants were creditors with such claims. Instead, the Trustee posits that Defendants' claims, to the extent they exceeded "principal," are invalid because they arose in the context of a Ponzi scheme and, therefore, must be treated like equity claims of defrauded investors. The Trustee's position cannot be sustained. The Trustee cannot avoid BLMIS' obligations to Defendants, and Madoff's fraud did not convert Defendants' claims as creditors to equity investments.

1. BLMIS' Obligations To Defendants Cannot Be Avoided

The Trustee's Complaint does not seek to avoid BLMIS' obligations to Defendants.[3] Indeed, the Trustee is not authorized to do so. SIPA section 78fff-2(c)(3), which authorizes a SIPC trustee to employ the avoidance provisions of the Bankruptcy Code, permits their use *only as to transfers*:

> "(3) RECOVERY OF *TRANSFERS*
>
> Whenever customer property is not sufficient to pay in full the claims set forth in subparagraphs (A) through (D) of paragraph (1), the trustee may recover any property *transferred* by the debtor which, except for such *transfer*, would have been customer property if and to the extent that such *transfer* is voidable or void under the provisions of title 11. Such recovered property shall be treated as customer property. For purposes of such recovery, the property so *transferred* shall be deemed to have been the property of the debtor and, if such *transfer* was made to a customer or for his benefit, such customer shall be deemed to have been a creditor, the laws of any State to the contrary notwithstanding." 15 U.S.C. § 78fff-2(c)(3) (emphasis added); *see also* 11 U.S.C. § 749(a) (same limitation as to unregistered broker liquidations).

Consistent with this limitation, Section 78fff-2(c)(3) also deems customers to be *creditors*, and Section 78fff-1(a) gives a SIPA trustee powers that include "the same rights *to avoid preferences*, as a trustee in a case under title 11." 15 U.S.C. § 78fff-1(a) (emphasis added). Creditors, by definition, have valid claims. Those claims constitute antecedent debt. Transfers on account of antecedent debt cannot be avoided as fraudulent. They can only be avoided as preferential.[4] Indeed, the Trustee's Complaint sought to

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[3] The Trustee has recently commenced a wholesale amendment of complaints in other cases to add counts for the avoidance of obligations, perhaps recognizing that those obligations otherwise constitute valid antecedent debt. *See, e.g.*, Am. Compl., *Picard v. Blumenthal*, 11 Civ. 4293, doc. no. 24, at ¶¶ 36-38 (S.D.N.Y. Dec. 2, 2011).

[4] The reason for Section 78ff-2(c)(3)'s limitation is readily apparent. Customers must rely upon their brokerage statements as evidence of what their broker is holding for

(…continued)

avoid transfers within the preference period based on the allegation that each was on account of antecedent debt. (Compl. ¶¶ 1380, 1385.) But under no circumstances can the Trustee avoid such transfers as fraudulent, particularly where, as here, no underlying obligation has been or can be challenged.

2. Creditor Claims Remain Creditor Claims in a Ponzi Scheme Insolvency

Because the Trustee cannot avoid BLMIS' obligations to Defendants, those obligations constitute valid antecedent debt, and transfers that satisfied those obligations were "for value." The Trustee has cited no case in which transfers to non-complicit customers of a registered broker were avoided as fraudulent—because there is none. Instead, the Trustee argues that, because BLMIS was operating a Ponzi scheme, the law is different than in other fraud cases. But the Trustee is wrong. The law is exactly the same. As this Court recognized, the existence of the BLMIS Ponzi scheme is a fact relevant to a finding of fraudulent intent on the part of the debtor. *Katz*, 2011 U.S. Dist. LEXIS 109595, at *14-15. That fact has no implications with respect to "value." And the critical difference between this case and the Ponzi scheme cases is that they address the *interests of equity holders in—not the claims of creditors against*—an insolvent entity.

(continued…)

them because they have no other evidence of securities ownership. SIPA was enacted to "promot[e] investor confidence in the securities markets and [to] protect[] broker-dealer customers." *In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 87 (2d Cir. 2004). Permitting a broker's obligations to be subject to fraudulent transfer risk, other than where customers were complicit in a fraud or other malfeasance, would be inimical to SIPA's objectives. Further, by enacting Section 546(e), which eliminates preference risk as well, Congress continued to expand protection for securities transactions.

The rights of creditors and equity holders are very different. Equity holders bargain for the right to participate in the increase in a firm's value and bear the risk of loss if that value decreases. *See ABF Capital Mgmt. v. Askin Capital Mgmt., L.P.*, No. 96 Civ. 2978, 1997 U.S. Dist. LEXIS 8195, at *8 (S.D.N.Y. June 11, 1997). An equity interest can never constitute debt, and an equity interest in an insolvent entity can neither have value nor give rise to any right to payment. By contrast, creditors bargain for contractual protections, which do not change with a firm's fortunes. Creditors have claims whether or not their counterparty is solvent. The ability to collect might change, but the claim does not.

A creditor claim constitutes antecedent debt. An equity interest does not. And when a firm becomes insolvent, creditors recover and equity interest holders do not. *See, e.g.*, *CFTC v. Weintraub*, 471 U.S. 343, 354-55 (1985) ("One of the painful facts of bankruptcy is that the interests of shareholders become subordinated to the interests of creditors . . . shareholders are [the] last to recover in bankruptcy."); *In re DBSD N. Am., Inc.*, 634 F.3d 79, 95 (2d Cir. 2011) (reversing bankruptcy plan approval that provided value to equity holders before all unsecured creditor claims were satisfied in full).

The cases cited by the Trustee for the proposition that net investment is the limit of any claim in a Ponzi scheme case all involve holders of equity interests. None recognizes any claim for antecedent debt, or "value," arising from the equity interest itself, which can have no value where a debtor is insolvent. However, they do recognize restitution claims for defrauded equity holders, and hold that such claims constitute "value" for avoidance purposes.

Thus, for example, the Trustee's key precedent, *Donell v. Kowell*, 533 F.3d 762 (9th Cir. 2008)—a receivership case under California law that did not involve SIPA, a broker, or Article 8—held that equity investors in a fraudulent scheme were entitled to restitution claims for net cash invested and that transfers to them could not be avoided to the extent of such claims. "Up to the amount that 'profit' payments return the innocent investor's initial outlay, these payments are settlements against the defrauded investor's restitution claim. Up to this amount, therefore, there is an exchange of 'reasonably equivalent value' for the defrauded investor's outlay." *Id.* at 777.

The Trustee's other Ponzi scheme cases reach similar conclusions. *See, e.g.*, *Perkins v. Haines*, 661 F.3d 623, 629 (11th Cir. 2011) (discussing transfers to defrauded equity investors and holding that "transfers from the Debtors up to the amount of the investment satisfied the investor defendants' restitution or fraud claims and provided value to the Debtors"); *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir. 1995) ("Phillips [a defrauded equity investor] is entitled to his profit only if the payment of that profit to him, which reduced the net assets of the estate now administered by the receiver, was offset by an equivalent benefit to the estate."); *In re Bayou Grp., LLC*, 439 B.R. 284, 308-09 (S.D.N.Y. 2010) (addressing claims against equity investors in bankrupt hedge fund who "gave value in the form of their initial investments, and have tort claims of rescission to recover all of their initial investment based on fraudulent inducement"); *Armstrong v. Collins*, No. 01 Civ. 2437, 2010 U.S. Dist. LEXIS 28075, at *67 (S.D.N.Y. Mar. 24, 2010) (addressing claims against equity investors and recognizing that "courts have held that a defrauded investor in a Ponzi scheme gives 'value' to the debtor in the form of a dollar-for-dollar reduction in the investor's restitution claim against the Ponzi scheme" (citations and internal quotation marks omitted)).

Under these cases, "value" exists for any valid claim against the debtor. For equity investors in a Ponzi scheme, that claim is limited to restitution. For Defendants, as creditors, their claims under Article 8 and the law of contract are for the value of the securities on their statements. Recognizing that the Ponzi scheme cases support him only if he can persuade this Court that BLMIS was not a broker, the Trustee now suggests that only *part* of BLMIS was fraudulent and perhaps that part should not be considered a broker—and perhaps Defendants should be treated as though they had been limited partners *in* BLMIS. The argument is specious. The Trustee admits that BLMIS was a registered broker (Trustee's Rule 56.1 Statement ¶ 1) and cannot dispute that Defendants were its customers.

Further, any suggestion that customer withdrawals constituted payments of "Other People's Money" is equally specious. Where an equity investor has no right to payment from an insolvent entity, a transfer on account of an equity interest is a transfer taken from creditors, who *do* have a priority right to payment. *See Weintraub*, 471 U.S. at 354-55; *DBSD*, 634 F.3d at 95. And the "idea that discrete objects might be traced through the hands of different persons has no place in the Revised Article 8 rules for the indirect holding system." UCC § 8-503 cmt. 2. Article 8 serves policies similar to those supporting finality with respect to electronic fund transfers. For example, in *Banque Worms v. BankAmerica Int'l*, 77 N.Y.2d 362, 372 (1991), the New York Court of Appeals, addressing a certified question from the Second Circuit, held that an erroneous funds transfer taken in good faith and for value could not be reversed, focusing on the need for finality.

> "This concern for finality in business transactions has long been a significant policy consideration in this State. In a different but pertinent context, we observed in *Hatch v Fourth Natl. Bank* (147 N.Y. 184, 192) that 'to permit in every case of the payment of a debt an inquiry as to the source from which the debtor derived the money, and a recovery if shown to have been dishonestly acquired, would disorganize all business operations and entail an amount of risk and uncertainty which no enterprise could bear.'" *Banque Worms*, 77 N.Y.2d at 372.

Banque Worms, decided in the context of a mistake, was then applied in *CFTC v. Walsh*, 17 N.Y.3d 162, 172 (2011), to support the conclusion that a transfer by the perpetrator of a Ponzi scheme to his ex-wife could, if taken in good faith and for consideration, be protected from avoidance. "It has long been the law of this State that 'money obtained by fraud or felony cannot be followed by the true owner into the hands of one who has received it bona fide and for a valuable consideration in due course of business.'" *Id.* at 172-73. Similarly, here, the fact that BLMIS was engaged in fraud cannot affect the validity of a transfer that otherwise was "for value."

II. THE TRUSTEE CAN NEITHER STATE NOR PROVE A FRAUDULENT TRANSFER CLAIM

As Defendants have demonstrated, their rights to the value of the securities reflected on their account statements were not limited to restitution claims, or net cash invested. Consequently, any transfer discharging those claims was "for value," and either the Trustee cannot state any claim for fraudulent transfer under Section 548(a)(1)(A) of the Bankruptcy Code, or Defendants have established that all transfers were "for value" as a matter of law for purposes of Section 548(c) of the Bankruptcy Code.

A. The Trustee Cannot Establish That Any Transfer Was Fraudulent Under *Sharp* and *Boston Trading*

The Trustee can state no fraudulent transfer claim. By definition, a payment to a creditor on account of valid antecedent debt is not a fraudulent transfer—it is at most a preference. "[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." *In re Sharp Int'l Corp.*, 403 F.3d 43, 54 (2d Cir. 2005) (citation omitted); *see also Lippe v. Bairnco Corp.*, 249 F. Supp. 2d 357, 375 (S.D.N.Y. 2003), *aff'd*, 99 F. App'x 274, 281 (2d Cir. 2004) ("[I]t is hornbook law that [a] conveyance cannot be fraudulent as to creditors if . . . [it] does not deplete or otherwise diminish the value of the assets of the debtor's estate remaining available to creditors." (internal quotation marks omitted)); *HBE Leasing Corp. v. Frank*, 48 F.3d 623, 634 (2d Cir. 1995) ("[T]he preferential repayment of pre-existing debts to some creditors does not constitute a fraudulent conveyance, whether or not it prejudices other creditors, because 'the basic object of fraudulent conveyance law is to see that the debtor uses his limited assets to satisfy *some* of his creditors; it normally does not try to choose among them.'" (quoting *Boston Trading Grp., Inc. v. Burnazos*, 835 F.2d 1504, 1509 (1st Cir. 1987))).

In *Sharp*, the Second Circuit held that no intentional fraudulent transfer claim was stated by a complaint that alleged fraud as to the *source* of the challenged payment, but not as to the *obligation* being paid, even when the transferee knew that it was being paid with fraudulently obtained funds.

> "[T]he intentional fraudulent conveyance claims fails for the independent reason that Sharp inadequately alleges fraud *with respect to the transaction that Sharp seeks to void*, *i.e.*, Sharp's $12.25 million payment to State Street. *See Boston Trading*, 835 F.2d at 1510 ("Fraudulent conveyance law is basically concerned with transfers that 'hinder, delay or

> defraud' creditors; it is not ordinarily concerned with how such debts were created.") (emphasis omitted).
>
> The fraud alleged in the complaint relates to the manner in which Sharp obtained new funding from the Noteholders, not Sharp's subsequent payment of part of the proceeds to State Street. The $12.25 million payment was at most a preference between creditors and did not hinder, delay or defraud either present or future creditors." 403 F.3d at 56 (internal quotation marks omitted).

Defendants respectfully submit that this holding, predicated on then-Judge Breyer's decision in *Boston Trading* to similar effect in the context of an actual fraudulent conveyance, establishes that no fraudulent conveyance claim—intentional or constructive—was stated because there was no allegation that that the obligation satisfied by the challenged transfer was itself invalid. Other decisions have reached the same conclusion. For example, in *Scholes*, 56 F.3d at 753, Judge Posner, also relying in part on *Boston Trading*, observed that, under the avoidance provisions of the Uniform Fraudulent Transfer Act ("UFTA"), which are nearly identical to those of the Bankruptcy Code, *see id.* at 756, an exchange for value is not voidable as fraudulent as between a debtor and its creditors:

> "It is apparent from the wording of the statute, as well as from its purpose, that if a transfer is made for commensurate consideration—if it is 'fair' in the sense of being one side of an equal exchange—it is not voidable. For creditors are not disturbed, delayed, hindered, or defrauded if all that happens is the exchange of an existing asset of the debtor for a different asset of equal value." *Id.* at 753.

The *Sharp* court's holding cannot be distinguished on the ground that it was not a Ponzi scheme case, so the payment was not part of the fraud. *See, e.g.*, *In re Manhattan Inv. Fund*, 397 B.R. 1, 11 (S.D.N.Y. 2007). When an entity is engaged in fraud, all transactions can be considered a "but for" cause of the fraud, and the repaid loan in *Sharp* is no exception.[5] Rather, *Sharp* recognized that non-complicit creditors are entitled to payment of antecedent debt, irrespective of the fraudulent intent of the transferor-debtor, and held that if a valid antecedent debt is paid, the payment can constitute neither constructive nor intentional fraud because it does not harm creditors. *See In re Churchill Mortgage Inv. Corp.*, 256 B.R. 664, 681 (Bankr. S.D.N.Y. 2000), *aff'd sub nom. Balaber-Strauss v. Lawrence*, 264 B.R. 303, 308 (S.D.N.Y. 2001) ("The significance or consequence of the . . . transaction as it relates to the Debtor's overall Ponzi scheme is of no relevance here.").

> "Fraudulent conveyance law, under both state and federal statutes, is concerned with the reality of whether the transferee conferred equivalent value on the debtor in the transaction sought to be avoided. The fact that the debtor's enterprise as a totality operated at a loss, or in a manner that is fraudulent, does not render actually or constructively fraudulent a particular transaction which in and of itself is not fraudulent in any respect." *In re Churchill Mortgage Inv. Corp.*, 256 B.R. at 681.

Nonetheless, the Trustee argues that *Sharp* and *Boston Trading* are inapposite because BLMIS was a Ponzi scheme, and it is "universally accepted that when investors invest in a Ponzi scheme, payments by the debtor that exceed their investment (i.e., fictitious profits) constitute fraudulent transfers." (Tr. Mem. at 26.) The Trustee relies upon *Bayou*, 439 B.R. at 304, and *In re Manhattan Investment Fund*, 359 B.R. 510, 517-18 (Bankr. S.D.N.Y. 2007), for the proposition that *every* payment in a Ponzi scheme is in furtherance of the fraud and, therefore, any payment in excess of net cash invested can never be "for value." (Tr. Mem. at 22-23, 25-26.) *Manhattan Investment Fund* stands for

[5] *Cf. In re Refco Inc.*, 461 B.R. 181, 198 (Bankr. S.D.N.Y. 2011) ("The Second Circuit in *Sharp* also made it clear that the mere existence of an underlying fraud on creditors . . . does not transform into a constructive fraudulent transfer a payment in satisfaction of an antecedent debt that enabled the fraudsters to further such fraud.").

no such proposition, as there was no dispute in that case that a creditor's antecedent debt created "value" for the challenged transfers. 359 B.R. at 523. And the *Bayou* Court, addressing fraudulent conveyance claims against *equity investors* in a Ponzi scheme, distinguishes *creditor* claims. 439 B.R. at 337.

In *Bayou*, a bankruptcy trustee sought to avoid redemptions by limited partner equity investors in a hedge fund that turned out to be a Ponzi scheme. An investor's claim for equity, which has no value against an insolvent entity, gives rise to no legal right or obligation on the part of the insolvent entity to make any payment to the investor. On the contrary, its assets are subject to the priority claims of creditors. Consequently, the District Court agreed with the Bankruptcy Court that:

> "[T]he conclusion is inescapable that corrupt Bayou Management authorized the fraudulently inflated redemption payments with 'actual intent to hinder, delay, or defraud' because there cannot be any other explanation for [transferors] to authorize redemption payments in amounts to which they knew the redeeming investors *were not contractually entitled* and which deepened the insolvency and damaged the remaining investors." *Id.* at 305-06 (emphasis added).

Because the *Bayou* court found that the debtor had no obligation to pay limited partners and, because it was insolvent, the debtor had no right to pay them, the payments necessarily hindered, delayed, and defrauded creditors. *Id.* at 305-06. The *Bayou* court recognized that, even though the debtor was insolvent in *Sharp,* the debtor *did* have an obligation to pay its creditor, and therefore its payments could not hinder, delay, or defraud creditors.

> "Because Sharp's complaint failed to plead that the loan repayment was made to 'hinder, delay or defraud' Sharp's creditors—and instead focused on 'the manner in which Sharp obtained new funding'—Sharp failed to make out a prima facie case of actual fraudulent conveyance. The Debtors here, however, specifically pled and demonstrated that the redemption payments hindered, delayed, and defrauded Bayou's creditors, by inter alia,

> forestalling disclosure of the fraudulent scheme." *Bayou*, 439 B.R. at 302 (citation omitted).

Here, contrary to *Bayou*, but consistent with *Sharp*, BLMIS had contractual obligations to its customers. Those obligations were not affected by BLMIS' insolvency. The Trustee has not sought to avoid those obligations. He challenges only the "manner in which BLMIS obtained new funding" with which to pay them. The facts of this case, therefore, align it with *Sharp* and *Boston Trading*, not with *Bayou*, and the law upon which all three cases are based support Defendants, not the Trustee.

B. Defendants Have Demonstrated That All Transfers Were "For Value" Under 11 U.S.C. § 548(c)

Finally, even where a *prima facie* fraudulent transfer claim is stated, a transfer taken "for value" and in good faith cannot be avoided under 11 U.S.C. § 548(c). Defendants have demonstrated in their summary judgment motion that no material factual dispute exists as to their good faith and herein have demonstrated that all challenged transfers were "for value."

Payments by fraudulent entities to *investors* on account of their *valueless equity interests* in insolvent schemes are legally unsupported, but payments to unwitting *creditors* on account of their *enforceable obligations* are legally mandated. Every withdrawal here was supported by a valid obligation that the Trustee has acknowledged. Under Section 548(d)(2), "value" is defined to include "antecedent debt." Because Defendants were creditors and not equity investors under Article 8 and other bodies of law, BLMIS owed them more than restitution damages—BLMIS owed them the securities on their statements. That obligation was not reduced or eliminated by BLMIS' fraud. Nor was it eliminated by BLMIS' SIPA filing. The onset of bankruptcy does not retroactively affect the existence of antecedent debt—state law rights must be respected both before and after bankruptcy. *See Butner v. United States*, 440 U.S. 48, 55 (1979). Therefore, all transfers to Defendants were "for value."

CONCLUSION

For the reasons set forth above and in Defendants' memorandum of law in support of their motion for summary judgment, the Trustee's partial motion for summary judgment must be denied.

Dated: New York, New York
February 9, 2012

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