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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re: BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Debtor,	Adv. Pro. No. 08-01789 (BRL) SIPA LIQUIDATION (Substantively Consolidated)
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. SAUL B. KATZ, et al., Defendants.	Adv. Pro. No. 10-05287 (BRL) 11 Civ. 03605 (JSR) (HBP)

TRUSTEE'S MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION IN LIMINE TO BAR USE OF PREJUDICIAL PHRASE

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Irving H. Picard (the "Trustee"), as Trustee for the substantively consolidated liquidation of the business of Bernard L. Madoff Investment Securities LLC ("BLMIS") and the estate of Bernard L. Madoff ("Madoff"), under the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§ 78aaa *et seq.*, by and through his undersigned counsel, respectfully submits this Memorandum of Law in Opposition to Defendants' Motion In Limine to Bar Use of Prejudicial Phrase. For the reasons set forth below, Defendants' motion in limine should be denied.

I. PRELIMINARY STATEMENT

Defendants' motion must be denied because the relief sought is at odds with the reality of the Ponzi scheme perpetrated by Madoff, as well as the rights of BLMIS customers in this SIPA proceeding. There is no dispute that, during the course of Madoff's fraud, BLMIS investors' funds were principally deposited into a bank account at J.P. Morgan Chase (the "703 Account").[1] The money received from customers was not invested in securities for the benefit of those customers as purported, but instead was primarily used to make distributions to, or payments on behalf of, other investors. As Madoff explained at his plea hearing, "Up until I was arrested . . . I never invested [customer] funds in the securities, as I had promised. Instead, those funds were deposited in [the 703 Account]. When clients wished to receive the profits they believed they had earned with me or to redeem their principal, I used the money in the [703 Account] that belonged to them or other clients to pay the requested funds." Ex. 2, to Sheehan Decl. to Trustee's Motion for Partial Summary Judgment, Dkt. No. 87. The transfers Defendants received from BLMIS therefore came from a commingled account and included or consisted of, at least in part, other people's money.

[1] The facts of Madoff's Ponzi scheme are not in dispute. See Trustee's Rule 56.1 Statement in support of his Motion for Partial Summary Judgment, Dkt. No. 87, and Defendant's Rule 56.1 Counter Statement, Dkt. No. 119.

Defendants' central premise is also flawed because "their money" is not at issue. Under SIPA, a fund of "customer property" is established for priority distribution to the "customers" of the debtor. *See* SIPA § 78*lll*(4)[2]; SIPA § 78*lll*(2). Each customer then has a claim to a pro rata share in the fund of customer property to the extent of his "net equity." *See* SIPA § 78*lll*(11); SIPA § 78fff-2(b). SIPA does not, as Defendants suggest in their motion, entitle any customer to a "return" of "their money" or "their principal."

Defendants' motion is an attempt to distort the framework of the case to be put before the jury by wrongly suggesting that the Trustee is seeking to recover "their money" as opposed to the recovery of Customer Property. Far from acting as a "later day Robin Hood," as Defendants brazenly suggest, the Trustee is fulfilling his undisputed, statutory mandate as set forth by Congress in SIPA. The Trustee distributes funds to customers with valid, approved claims on an equitable and ratable basis—without regard to economic status, or any other factor. To suggest that the Trustee is somehow in the business of stealing from the rich and giving to the poor is both patently false and highly prejudicial.

Defendants' motion must be denied because the Trustee's reference to "other people's money," or any like wording, is completely accurate and not at all prejudicial when describing to the jury the nature of a Ponzi scheme. The $300 million-plus in transfers at issue for trial consist of funds that were stolen from other BLMIS customers from a single, common account (before being conveyed to Defendants in furtherance of Madoff's admitted Ponzi scheme.) As such, it would in fact be unfairly prejudicial to the Trustee to allow the Defendants to describe the funds

[2] SIPA § 78lll(4) defines "Customer Property" as "cash and securities . . . at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted."

remaining at issue to the jury as somehow "their money" or as a "return" of "their principal" when the undisputed facts belie such characterizations.

II. ARGUMENT

A. The Central Premise of Defendants' Motion is Untenable Given the Undisputed Facts and the Established SIPA Procedures

Defendants' motion must be denied because its central premise is wrong. The hundreds of millions in transfers that remain the subject of trial do not consist of funds that are accurately characterized as the "Defendants' principal." (Def. Mot. p. 2). BLMIS did not maintain the funds at issue in segregated accounts in Defendants' names before "returning" them to any Defendant. Rather, BLMIS commingled Defendants' deposits in an unsegregated account with money from *all* investors. The transfers at issue, therefore, consist of and include "other people's money."

The money flowing out of BLMIS to its customers came from the common, non-segregated 703 Account. *See* Ex. 2 to Sheehan Decl. to Trustee's Motion for Partial Summary Judgment, Dkt. No. 87. Upon the liquidation of BLMIS under SIPA, this cash and any recoveries of customer property by the Trustee are to be distributed ratably to all customers with net equity claims. *See* SIPA § 78*lll*(11); SIPA § 78fff-2(b). No customer has an identifiable interest in specific funds, but rather has a pro rata claim to a share of the customer fund. *Rosenman Family LLC v. Picard*, 395 Fed. Appx. 766, 769 (2d Cir. 2010) (affirming that funds transferred by investor to BLMIS formed part of the debtor's property and the bankruptcy estate, and are therefore subject to SIPA); *In re Adler Coleman Clearing Corp.*, 211 B.R. 486, 496 (Bankr. S.D.N.Y. 1997) (customers' assets transferred into a Ponzi scheme constitute "customer property" against which customers do not have an identifiable interest to their investments, but rather simply have a claim against the collective pot of funds). This is consistent with case law

recognizing that, in a fraudulent scheme where investors' money is extensively commingled with the money of other investors such that the funds are impossible to segregate, each investor is limited to his or her pro rata interest in the entire asset pool. *United States Commodity Futures Trading Comm'n v. Linton*, 786 F. Supp. 2d 1374, 1382 (D. Ariz. 2011) (citing *SEC v. Better Life Club of Am., Inc.*, 995 F.Supp. 167, 181 (D.D.C. 1998)). At best, if the Defendants were able to sustain their affirmative defense under section 548(c), any "right" to retain funds that satisfied their principal investment is not a recognition that it was a return of "their money" or "their specific funds," but rather a recognition of a right to a restitution claim, up to their principal amount invested, as a result of the fraud. *See Donell v. Kowell*, 553 F.3d 762, 773 (9th Cir. 2008).

Madoff operated a Ponzi scheme which commingled customers' assets. The funds the Sterling Defendants transferred to BLMIS were used to make payments to earlier investors, and the transfers received by the Sterling Defendants were funds BLMIS received from later investors. By the Ponzi scheme's very nature, the hundreds of millions of dollars Defendants placed into their 180-plus accounts over time neither "belonged" to any of the Defendants nor were allocable specifically to them; rather, BLMIS placed the funds into a commingled, common fund of customer property belonging to all customers with valid claims on a pro rata basis. As such, the transfers received by the Sterling Defendants do not constitute "their money" or "their principal," and references to these transfers as consisting of or including "other people's money" are in no way unfair. *See Costantino v. Herzog*, 203 F.3d 164, 174 (2d Cir. 2000) ("Because virtually all evidence is prejudicial to one party or another, to justify exclusion under Rule 403 the prejudice must be *unfair*.") (emphasis in original) (citing *Weinstein's Federal Evidence* § 403.04[1][a] (2d ed. 1997)). To show unfairness, Defendants must identify "some adverse effect

beyond tending to prove a fact or issue that justifies admission." *Id*. at 174-75; *see also U.S. v. Ruskjer*, Crim. No. 09-00249HG, 2011 WL 3841854 at *4 (D. Haw. Aug. 29, 2011) (denying motion to preclude use of term "Ponzi scheme" because it merely described the alleged activity in a succinct fashion and did not pose a danger of unfair prejudice or misleading the jury).

The cases cited by Defendants in their motion regarding the exclusion of "pejorative" terms are inapposite and as such support the Trustee. Those cases involved terms and phrases that were facially pejorative and derogatory with respect to the defendants themselves and/or their alleged conduct – not at all the case here. *See Plew v. Limited Brands, Inc.*, No. 08 Civ. 3741, 2012 U.S. Dist. Lexis 14966, at *6-7 (S.D.N.Y. Feb. 6, 2012) (finding characterization of Defendants' actions as "stealing" pejorative); *Aristocrat Leisure Ltd. v. Deutsche Bank Trust Co. Ams.*, No. 04 Civ. 10014, 2009 U.S. Dist. LEXIS 89183, at *19-20 (S.D.N.Y. Sept. 28, 2009) (finding use of term "tax haven" inflammatory and derogatory); *AIA Holdings, S.A. v. Lehman Bros., Inc.*, No. 97 Civ. 4978, 2002 U.S. Dist. LEXIS 22559, at *2-3 (S.D.N.Y. Nov. 21, 2002) (denying in part and granting in part motion to exclude term "rat trading"). The Trustee's use of the phrase "other people's money," by contrast, is a *factual* characterization of the transfers from BLMIS, explains the Ponzi scheme's inner workings, explains what the Trustee is doing via the action before the jury, and is not at all pejorative with respect to Defendants. *See Aristocrat Leisure*, 2009 U.S. Dist. LEXIS 89183 at *20 (declining to exclude factual terms including "hedge funds," "short selling," and "off-shore incorporation" because they were not inflammatory on their face).[3]

[3] *Highland Capital Mgmt. L.P. v. Schneider* is likewise inapposite because in that case, the court precluded use of terms such as "securities fraud", "insider trading", and the like because no securities claims were at issue in a breach of contract action, and those terms were only intended to make the Defendants themselves look like "bad people." 551 F. Supp. 2d 173, 192 (S.D.N.Y. 2008). However, the court did allow use of the factual term "material nonpublic information." *Id.* at 193.

Defendants' assertion (Def. Mot. p. 6), that "there is no evidence Defendants received anyone else's money other than their own" is completely wrong. The evidence at trial will show precisely that – Madoff ran a Ponzi scheme and Defendants' received money from commingled funds belonging to all BLMIS customers. It is the Defendants who cannot point to any evidence that the money they received consisted of their segregated funds. Defendants' further assertion that use of the phrase "other people's money" implies that the standard of willful blindness is automatically met (Def. Mot. p. 6) is a *non sequitur* and a stretch. Whether the Defendants were willfully blind to signs of Madoff's fraud is a separate issue from the commingled nature of the funds received by Defendants. That Defendants received other people's money is a relevant, accurate fact and an inherent result of the Ponzi scheme run by Madoff. The jury will make the ultimate determination as to whether Defendants were willfully blind to the warning signs of Madoff's fraud.

B. The Relief Sought By Defendants Would be Unfairly Prejudicial to the Trustee

The relief sought by Defendants, or allowing them to make reference to "*their* principal" or similar descriptions of the transfers at issue, would in fact be unfairly prejudicial to Trustee. Allowing the Defendants to manipulate the terminology of the case in this manner would create the false impression that the Trustee is somehow attempting to re-distribute "Defendants' money" to less fortunate, less culpable, or less sophisticated customers. To the contrary, the Trustee takes valid claimholders as he finds them. He simply seeks to recover Customer Property for equitable distribution on allowed claims in accordance with SIPA.

What is "fair" must be determined with reference to the undisputed facts. *Sprint/United Mgmt v. Mendelsohn*, 552 U.S. 379, 388 (2008) (stating that "[a]pplying Rule 403 to determine if evidence is prejudicial also requires a fact-intensive, context-specific inquiry."). Here, the facts

concerning the commingled funds at BLMIS support the Trustee's characterization of "other people's money" and foreclose the Defendants' efforts to misconstrue the transfers as "*their* principal."

Similarly, Defendants' motion is a backdoor and belated attempt to hamstring the Trustee's forensic accounting expert.[4] Indeed, Defendants' motion (pp. 5-6) takes broad aim at the report of Bruce G. Dubinsky, who will testify about, among other things, the operations of BLMIS and its lack of legitimacy, certain of the Defendants' accounts, and Madoff's purported investment strategy. Mr. Dubinsky must be allowed to accurately testify to the relevant facts regarding the Ponzi scheme and how it operated. These facts are directly relevant to establishing the legal basis for the Trustee's claims, and necessarily include reference to the commingling of funds and the fact that "redemptions" from BLMIS consisted of or included other people's money. Any challenge Defendants wish to make with regard to the assumptions or conclusions of Mr. Dubinsky should be done through the cross-examination of Mr. Dubinsky at trial.

III. CONCLUSION

For the foregoing reasons, the Court should deny Defendants' motion, and should bar Defendants from referring to the transfers at issue as "their money," "their principal" or by any like characterization or phrasing.

[4] Motions to strike experts were due on January 26, 2012. Defendants filed no motion as to Mr. Dubinsky and thus this "argument" is untimely.

Dated: New York, New York
March 12, 2012

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