Irving H. Picard v. Saul B. Katz et al
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**UNITED STATES BANKRUPTCY COURT**
**SOUTHERN DISTRICT OF NEW YORK**

| | |
|---|---|
| SECURITIES INVESTOR PROTECTION CORPORATION,<br><br>Plaintiff-Applicant,<br><br>- against -<br><br>BERNARD L. MADOFF INVESTMENT SECURITIES LLC,<br><br>Defendant. | Adv. Pro. No. 08-01789 (BRL)<br><br>SIPA LIQUIDATION<br><br>(Substantively Consolidated) |
| In re:<br><br>BERNARD L. MADOFF,<br><br>Debtor. | |
| IRVING H. PICARD,<br><br>Plaintiff,<br><br>- against -<br><br>SAUL B. KATZ, et al.<br><br>Defendants. | Adv. Pro. No. 10-05287 (BRL) |

**REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF STERLING DEFENDANTS' MOTION TO DISMISS THE AMENDED COMPLAINT OR, IN THE ALTERNATIVE, FOR SUMMARY JUDGMENT**

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The Sterling Defendants respectfully submit this reply memorandum of law in further support of their motion to dismiss or, in the alternative, for summary judgment dismissing the Trustee's Complaint and in response to the opposition briefs filed by the Trustee ("Trustee Opp.") and the Securities Investor Protection Corporation ("SIPC Opp.").

## PRELIMINARY STATEMENT

The Trustee, a fiduciary for customers victimized by Bernard L. Madoff, has embarked upon a vast and unprecedented campaign against those very customers, chief among them the Sterling Defendants, from whom he demands one billion dollars.

In their moving papers, the Sterling Defendants demonstrated that the factual allegations in the Complaint, certified by fourteen lawyers as having evidentiary support, in fact have none. In response, the Trustee was required to produce his evidence, of which he claims to have an "ample" "array." Instead, he has made additional overwrought claims about insurance "shopping sprees" and "screaming" demands to get away from Madoff that are equally unsupported—and contradicted—by the evidence. To support his allegations of "willful blindness," he points to a few emails, sent *after* Madoff's arrest—all of which are contradicted by sworn testimony and none of which even suggests that any Sterling Defendant was given any warning that Madoff was illegitimate. In addition, the content of the emails is largely inadmissible hearsay.

Perhaps aware that he needs more, the Trustee asks for additional discovery. He does not say what he hopes to find. But his Complaint was filed after *every* Sterling witness the Trustee sought to interview or examine under oath was made available, after the Sterling Defendants responded to *all* agreed-upon document requests, and after many

third parties provided testimony and documents in response to demands from the Trustee. There is nothing else to find.

Nor is there any legal basis for the Complaint. BLMIS was a registered broker. The Sterling Defendants were customers. BLMIS was obligated to them for the securities on their brokerage statements. Payments discharging these antecedent debts to the Sterling Defendants cannot be avoided as fraudulent, unless the Trustee can prove that the obligations themselves were unenforceable because the Sterling Defendants participated in the fraud.

The Trustee has not even alleged, nor can he show, complicity. Therefore, he and SIPC contend that in *this* case the rules are entirely different. In *this* case, the Securities Investor Protection Act ("SIPA") supersedes the Bankruptcy Code and other securities laws to allow the Trustee to avoid lawful transfers over several decades—all to further their self-defined "equality" objective, found nowhere in SIPA. This interpretation puts SIPA in direct conflict with the other securities laws and with the Bankruptcy Code.

SIPC and the Trustee are wrong. The Sterling Defendants were customers of a regulated broker—they were not equity investors in a hedge fund. The Bankruptcy Code does not permit avoidance of transfers as fraudulent that extinguished valid debt. This is not, therefore, a conventional avoidance action. Although SIPC and the Trustee contend that SIPA overrides the limits of the Bankruptcy Code, it does not. None of SIPA, the other securities laws, or the Bankruptcy Code permits the result sought by SIPC and the Trustee.

The Trustee's Complaint has neither a factual nor a legal foundation and must be dismissed.

## THE COMPLAINT'S STILL-FALSE ALLEGATIONS AND THE REAL AND UNCONTROVERTED FACTS

**Newly Highlighted False Allegation #1: The Sterling Partners "Shopped" for Ponzi Scheme Insurance**

The Trustee alleged in his Complaint that a friend and colleague of the Sterling Partners, Chuck Klein, "raised certain concerns about Madoff with Saul Katz," and that, upon information and belief, Mr. Klein "recommended" to Mr. Katz "fraud insurance" that his company, American Securities, had procured for its Madoff investments. (Compl. ¶¶ 940, 942-944.)

In his opposition brief, the Trustee has enlarged greatly upon this vignette, making sweeping allegations about a shopping spree for fraud insurance, based on suspicions that Madoff was running a Ponzi scheme, that "establishes incontrovertibly" that the Sterling Partners were on "inquiry notice" of Madoff's fraud as early as 2001 (Trustee Opp. at 6, 30, 43), all of which demonstrates that Saul Katz is lying when he says that he never knew or suspected Madoff's Ponzi scheme. (*Id.* at 41.) Why, the Trustee asks, would the Sterling Defendants have "solicited quotes" for Ponzi scheme insurance for their Madoff investments if they did not have "concerns that Madoff was engaging in a fraud"? (*Id.* at 6, 30, 43.) This fiction was repeated and republished by the press. *See, e.g.*, Serge Kovaleski, *Mets Looked at Fraud Coverage for Madoff Stakes*, N.Y. Times, May 19, 2011, at B13.

But these allegations are false. None of them is in the Trustee's Complaint, the depositions taken by the Trustee directly contradict them, and the Trustee offers no evidence to support them—or to controvert the evidence refuting them. The Sterling Defendants *never* suspected Madoff was running a Ponzi scheme or any other fraudulent

enterprise, *never* "shopped" for fraud insurance, *never* thought they needed fraud insurance, and *never purchased* fraud insurance for their BLMIS investments.

> "Q. . . . Do you recall any point in time at which you considered purchasing insurance to cover your investments in Madoff?
>
> [S. Katz]. I recall looking at and considering that.
>
> Q. Tell me what you recall about that.
>
> A. I recall friends of mine who were more conservative than I am—and I'm very conservative—talked about doing it and asked us to look into it.
>
> Q. Who were the friends?
>
> A. The friends at American Securities, my friend Chuck Klein.
>
> Q. And did you have an understanding that American Securities had purchased insurance?
>
> A. I think he said they were going to, or considering it.
>
> Q. And so what did you do when you learned about this?
>
> A. We weren't going to buy insurance on something that we thought was as good as gold and waste money.
>
> Q. So what steps did you take to investigate, if any, what steps did you take to investigate the insurance aspect of this?
>
> A. I think I asked Mr. Friedman to investigate it and see what the costs are. But that's because of my respect for Mr. Klein who said, just take a look at it. So we took a look at it." (S. Katz Tr. 100:17-101:21 (objection omitted) (Seshens Supp. Decl., Ex. T).)[1]

* * *

[1] Short-form record citations set forth herein relate to the same evidentiary source as they did in the Sterling Defendants' moving memorandum of law ("Sterling Br."). Citations to the "Seshens Supp. Decl." pertain to the June 20, 2011 Supplemental Declaration of Dana M. Seshens in Further Support of Sterling Defendants' Motion to Dismiss the Amended Complaint or, in the Alternative, for Summary Judgment.

“Q. I think you told me that the idea to look into that insurance came about because you learned that American Securities had purchased insurance?

[S. Katz]. No. I said that my friend Chuck Klein asked me to look into it because he had done so. He requested I look into it.

Q. So Chuck Klein had looked into it. This was American Securities, right?

A. Yes.

Q. Did you understand that he had purchased the insurance?

A. No.

Q. Did you understand that he had not purchased the insurance?

A. No.

Q. Did not have an understanding either way?

A. To this day I don’t know whether he did or he didn’t.

Q. Did you have an understanding of why he looked into such insurance?

A. No.

Q. Do you recall asking him about that?

A. No.

Q. Did you have an understanding about whether the insurance that he was looking into and either had or hadn’t purchased was related to investment in Madoff or in some other—

A. I think he covered more, more than Madoff, I think he covered his whole portfolio.

Q. What do you base that belief on?

A. My recollection.

Q. Something he said or something you assumed?

> A. No, no. That's what I recall he was talking about. He wasn't talking about Madoff in particular. As I recall he was talking about his whole portfolio." (*Id.* 229:15-231:3.)
>
> * * *
>
> "Q. Other than learning that American Securities had purchased third-party insurance for their accounts at Madoff, was there any other precipitating event that made the Sterling Group think insurance was a good idea, potentially?
>
> [Friedman]. No." (Friedman Tr. 424:20-425:1 (objection omitted) (Seshens Supp. Decl., Ex. U).)
>
> * * *
>
> "Q. Going back to our discussions about insurance that was considered by Sterling related to its Madoff investments . . . do you know why that was considered by Sterling?
>
> [D. Katz]. Only that Chuck [Klein] mentioned it.
>
> Q. Do you know if Chuck recommended it?
>
> A. I don't know."[2] (D. Katz Tr. 315:6-14 (Seshens Supp. Decl., Ex. V).)

In a particularly appalling distortion of the testimony of Arthur Friedman, the Trustee contends "that the Sterling Partners themselves not only suspected Madoff might be engaging in fraudulent activity, but . . . they even suspected *specifically* that their BLMIS investments might be involved in a Ponzi scheme." (Trustee Opp. at 9 (emphasis added).) The testimony of Mr. Friedman is that he did not even know what a Ponzi scheme was. (Sterling Br. at 42 & n.19.)

[2] The Trustee's attempt to link the timing of the Sterling Defendants' consideration of the third-party fiduciary policy suggested by American Securities to the publication of two publicly disseminated articles about Madoff in 2001 is unfounded. (Trustee Opp. at 7-8.) There is no evidence of any linkage. When asked whether there was a reason that the meeting with the insurance broker was not set up until June 2001, when the initial memo on the subject was drafted in February 2001, Arthur Friedman stated that "for the most part the reason was that there was no sense of urgency. But whether he wasn't available or we weren't available, that I don't recollect." (Friedman Tr. 428:14-23 (Seshens Supp. Decl., Ex. U).)

"Q. Do you understand the beginning of your notes to be describing the scope of coverage?

A. Yes.

Q. And this was based on the discussion that took place in June of 2001?

A. Yes.

Q. And the first line says, 'Fraud or fidelity'?

A. Correct.

Q. And then in parens it says 'Ponzi'?

A. Yes.

Q. What was the conversation that surrounded those notes?

A. This, to some extent I'm guessing, but that, he mentioned, I have some recollection of him giving examples of what types of fraud, and Ponzi was one of them. You can see I wasn't even quite sure how to spell Ponzi.

Q. I see.

A. I'm not sure how I wound up ultimately, either. It's hard to read.

Q. Looks like you've got an E on the end.

A. I think so, too.

Q. Did you know what a Ponzi scheme was at that time?

A. I don't think I did.

Q. Was there any discussion of Madoff in particular during the course of this meeting?

A. No." (Friedman Tr. 430:18-431:22 (Seshens Decl., Ex. H).)

There is no evidence to support the Trustee's "shopping spree" contention, which, in any event, cannot carry the weight of the Trustee's billion-dollar demand.

Although the Trustee has refused to provide the Sterling Defendants with his pre-Complaint discovery, the Sterling Defendants have reason to believe that he has taken the sworn testimony, or at least interviewed, many or all of the third parties who play a role in the Complaint. Given the prominence of these "shopping spree" allegations, Mr. Klein surely provided testimony.[3] Yet the Trustee has put forth no evidence from Mr. Klein. If the Trustee possessed evidence that supported the existence of this "shopping spree" and the supposed reasons for it, he was compelled to come forward with that evidence, including any from Mr. Klein. That he has not done, which suggests once again that he has no evidence to support this claim.

**Newly Highlighted False Allegation #2: David Katz Was "Screaming" for Diversification Because He Viewed Madoff's "Black Box" Strategy as an Indication of Fraud**

The Trustee's second newly elevated insinuation is that David Katz was "screaming" to diversify away from BLMIS because he thought Madoff's black box strategy meant that he was engaged in a fraud. (Trustee Opp. at 10-11.) The testimony is entirely to the contrary. The Sterling Partners were indeed seeking to diversify their investments in 2002, in part at David Katz's suggestion, but there is not a scintilla of evidence that either David Katz or any other Sterling Partner had any concern about Madoff. Indeed, as Mr. Katz points out, if the Sterling Partners *had* been concerned, they would have taken *all* their money out.

[3] In addition, the Trustee has sued American Securities. His complaint is under seal. Compl., *Picard v. Am. Sec. Mgmt., L.P.*, No. 10-05415, doc. no. 1 (Bankr. S.D.N.Y. Dec. 10, 2010). If the Trustee has claimed that Mr. Klein's insurance recommendation was a supposed "red flag" for the Sterling Defendants, presumably the Trustee has asserted the same contention in that case.

“Q. . . . Would you agree that one of the purposes of Sterling Stamos was to diversify away from Madoff?

[D. Katz]. Yeah. Yes.

* * *

Q. Was the fact that Madoff was a black box one of the reasons Sterling wanted to diversify away from Madoff?

A. No.” (D. Katz Tr. 346:23-347:19 (objection omitted) (Seshens Supp. Decl., Ex. V).)

* * *

“Q. Do you recall actually raising the issue of diversification in the ’90s?

A. I remember one conversation specifically and I’m not sure of the year.

Q. What is that one conversation specifically that you recall?

A. That’s the one I had with my father in his office, where I was trying to get him to focus, which isn’t easy sometimes, and I asked him, you know, if he was dead, he looks down, he’d think I’m insane, if he saw me doing this, put all my money in one place[.] [H]e’d think I was insane and he’d kill me.

Q. Why would he think you are insane?

A. Can’t have all your money in one place. I’m supposed to be taking care of my sisters and it’s not—doesn’t make sense.” (*Id.* 80:12-81:3.)

* * *

“Q. . . . And that conversation in the ’90s, did you talk about Madoff’s strategy in any way?

A. No.

Q. . . . Did you talk about any concerns that either of you had about Madoff, if any?

A. Other than there’s too much money in one place?

Q. Yes.

A. *No. That was the only thing. Otherwise we'd take everything out.*" (*Id.* 84:12-25 (emphasis added).)

* * *

"Q. I just want to go back for a second to our discussions about Bernie being a black box.

A. Yup.

Q. Can you tell me why, or did you think that was problematic?

A. In what way?

Q. Was there anything about Bernie being a black box that concerned you?

A. No.

* * *

Q. . . . What does black box mean to you exactly?

A. It's a proprietary trading method.

Q. Proprietary trading method meaning what?

A. Meaning it's secret.

Q. And is there anything about the trading method being secret that you have, that you would have concerns about?

A. Not in this case, no, absolutely not.

Q. Why not?

A. Well, I guess Bernie was an outstanding citizen. He helped computerize NASDAQ, SEC writes rules with him. A lot of reasons.

Q. I guess putting Bernie aside, just the black box strategy in general . . . with a particular investment manager . . . would you be concerned if an investment manager had a black box strategy?

A. No." (*Id.* 145:9-147:7.)

* * *

"Q. [W]hat do you recall [David Katz] saying other than, [w]e ought to diversify? Do you recall him saying anything more than that?

[A. Friedman]. It was just—no warning about Madoff or any uneasy feeling about Madoff. It's just a good idea[,] which nobody disagreed with, to spread money to more than one place." (Friedman Tr. 353:1-7 (Seshens Supp. Decl., Ex. U).)

* * *

"Q. Do you recall whether your son David had an opinion about the double-ups, whether that was a good idea or a bad idea from a business perspective?

A. My son David, as I think I testified earlier, felt as though we had too much in one place.

Q. And the double-ups would add to that?

A. Double-ups would add to that. So if we had too much in one place, too much plus something, it just compounds the lack of diversity.

Q. Did he voice that opinion to the group?

A. Many times. Never about the asset.

Q. I understand.

A. Never about the asset.

Q. Just about the fact of too much money in one place?

A. Too much in one place."[4] (S. Katz Tr. 176:13-177:6 (Seshens Supp. Decl., Ex. T).)

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[4] Ashok Chachra's testimony is entirely consistent. (Chachra Tr. 136:25-137:14 ("Q. [D]id anyone ever ask why Katz/Wilpon wanted to diversify their investment from Madoff? A. I think it was obvious. No. People said—I don't remember anyone specifically asking why, because if they had a single manager concentration[,] it would be implicit within that statement. Q. So the answer is no, you don't recall? A. I don't recall anyone asking me why they would want to diversify, no.") (Seshens Supp. Decl., Ex. W).)

**Uncontroverted Fact #1: Neither Sterling Stamos Nor Anyone Else Ever Told the Sterling Partners That Madoff Was a "Scam" or a Fraud**

In a stunning retreat from his widely publicized contention that Sterling Stamos personnel warned the Sterling Partners that Madoff was a "scam" or a "fraud," the Trustee offers no evidence whatsoever to refute the proof offered by the Sterling Defendants that no such warnings were given. He cannot contradict Peter Stamos' testimony that he thought, up until the day Madoff's fraud was revealed, that Madoff was "legendary," "perhaps one of the best hedge fund managers in modern times," and "among the most honest and honorable men that we will ever meet"—not a "fraud" or a "scam." (Sterling Br. at 6-7.) Nor does the Trustee dispute Mr. Chachra's testimony that before December 11, 2008 he thought Madoff was "very talented" and a "pioneer" and had "no reason to think there was anything wrong [at BLMIS]." (*Id.* at 7.)

Instead, the Trustee refers to a handful of *post-arrest* emails, contending that they are better evidence than the witnesses' own sworn testimony as to what they thought *before* Madoff's arrest—in essence, attacking their credibility. He has no evidentiary basis for any such attack, nor can this strategy defeat summary judgment.

First, *none* of the emails on which the Trustee relies was sent prior to Madoff's arrest on December 11, 2008. (*See, e.g.*, Trustee Opp. at 23-24; May 19, 2011 Declaration of Fernando A. Bohorquez, Jr. in Support of the Trustee Opp. ("Bohorquez Decl."), Exs. 21 (dated Dec. 14, 2008), 22 (dated Dec. 14, 2008), 29 (dated Dec. 12, 2008), 30 (dated Dec. 11, 2008).) Had there been any pre-December 11, 2008 communication warning the Sterling Partners that Madoff was a fraud or a scam, the Trustee's extensive discovery of Sterling and of Sterling Stamos would have revealed it.

Second, even the post-arrest emails do not state that any warning was communicated to the Sterling Defendants.

Third, these emails have not been authenticated and reflect inadmissible hearsay. As a matter of law, therefore, the emails cannot raise any genuine dispute of material fact. (*See infra* at 34.) The Trustee relies most heavily on hearsay statements attributed to Ashok Chachra in a December 12, 2008 email, arguing that it proves that Mr. Chachra "had fingered Madoff as a fraud for years" and "always said it was a scam, 'too good to be true.'" (Bohorquez Decl., Ex. 29.) The email is not authored by Mr. Chachra. It is double hearsay and, therefore, inadmissible. *See, e.g.*, *Pittman v. Grayson*, 149 F.3d 111, 124 (2d Cir. 1998) (analyzing as double hearsay and excluding a witness's out-of-court statement "repeating a story she had heard from someone else" because the second level of hearsay did not come within a hearsay exception); *In re Parmalat Sec. Litig.*, 659 F. Supp. 2d 504, 528 (S.D.N.Y. 2009) (analyzing as double hearsay documents containing "unsworn summaries by Italian police of unsworn statements allegedly made to them" and denying their admissibility for hearsay at both levels).

The Trustee never asked Mr. Chachra about this email during his deposition or made any other effort to address his evidentiary deficiency, even though—or, perhaps, because—prior to Mr. Chachra's deposition, Peter Stamos had already told the Trustee, when *he* was questioned about this email, that no one at Sterling Stamos described Madoff in those words. (Sterling Br. at 6-7.) And the email is contrary to Mr. Chachra's own sworn statement. (Chachra Decl. ¶ 4.)

The Trustee also relies on two December 14, 2008 emails from Basil Stamos in which he states that his brother Peter "called" the Madoff fraud "over 7 years ago."

(Trustee Opp. at 23-24; Bohorquez Decl., Exs. 21, 22.) These emails too reflect inadmissible hearsay, legally insufficient to raise a material question of fact. In addition, their content is not probative. No other evidence of what anyone thought during the "7 years" prior to Madoff's arrest is offered to corroborate Peter Stamos' supposed "call." And, in 2001, seven years before Madoff's fraud was disclosed, Peter and Basil Stamos, and other Stamos family members and affiliates, all were BLMIS customers. (*See, e.g.*, Bohorquez Decl., Ex. 5.) Peter and Basil Stamos remained BLMIS customers until 2004,[5] and Peter Stamos had a very positive view of Madoff until the day his fraud was disclosed. (Stamos Tr. 146:6-21 (Seshens Decl., Ex. A).) Nor do the emails refer to any communication with the Sterling Defendants. Basil Stamos' emails, therefore, can raise no dispute of material fact as to the knowledge of the Sterling Defendants.

The Trustee's only other "evidence" of any warning simply confirms that Peter Stamos warned the Sterling Partners about concentration, or single-manager, risk. Although the Trustee selectively edits and misconstrues testimony from Arthur Friedman to argue that Peter Stamos "warned that Madoff might be investigated and that their funds at BLMIS could be frozen" (Trustee Opp. at 20, 30, 37), Arthur Friedman testified that any such concern was entirely hypothetical and any "warning" had to do with the Sterling Partners' investment concentration risk:

> "[Friedman]. The only danger that he put forth was that if anything ever happened, *and he didn't really get into any reason that anything should happen, a problem with Sterling, that Sterling might encounter*, would be

[5] (Sterling Br. at 22 (citing Stamos Tr. 117:5-25 (explaining that Peter Stamos withdrew his BLMIS funds in 2003 and 2004 for personal reasons and to invest in Sterling Stamos) (Seshens Decl., Ex. A)); Letter from Arthur Friedman to Frank DiPascali, dated Oct. 28, 2004 (account closing instructions for Basil Stamos' 1KW BLMIS account) (Seshens Supp. Decl., Ex. X).)

> if accounts were frozen and while any kind of—if they started to look into Madoff's operation—*again, not saying that they'd find anything*, but just saying, just creating a fear of just an investigation. And our accounts were frozen, would we—and at the same time the banks said, well, pay us the money, you're in default, *we [Sterling] might have a problem*.
>
> So that was the only—that was the basis of his warning, we'll say, or *saying that you should have less money*. Again, not that he could point to and say there's something wrong or an investigation would turn up anything wrong. Just that if there were an investigation and if the money was tied up, *then we [Sterling] might run into a problem*." (Friedman Tr. 578:2-579:23 (emphasis added) (Seshens Supp. Decl., Ex. U).)

Finally, the Trustee alleges that Sterling Stamos' performance itself was some sort of warning as to the fraudulent nature of BLMIS' operations. (Trustee Opp. at 31-32.) He claims that the Sterling Partners regularly compared the returns achieved by Sterling Stamos with those achieved by BLMIS and gave Peter Stamos "crap" for failing to make the same returns. He goes so far as to suggest that Saul Katz's plan to move a substantial amount of his money invested in Sterling Stamos to BLMIS *the week before* Madoff's fraud was disclosed evidences a "deliberate risk assessment" made by the Sterling Partners to maintain their BLMIS investments at any cost. (*Id.*) He avers that the "Sterling Partners' driving motivation to continue the flow of 'Madoff-like' returns" at Sterling Stamos demonstrates that they participated in Madoff's fraud. (*Id.* at 12.)

The Trustee's evidence proves exactly the contrary and his contentions are nonsensical. The fact that the Sterling Partners expected "Madoff-like returns" at Sterling Stamos proves that they thought there was a basis for Sterling Stamos to achieve such returns. If they had thought BLMIS' returns were the product of fraud, they could not have expected Peter Stamos to replicate those results and would not have given him "crap" when he did not. And no sentient person makes a "deliberate" decision to

continue investing in a fraud, putting hundreds of millions of dollars knowingly at risk. The Trustee's theory is implausible, and he offers no evidence with which to support it.

**Uncontroverted Fact #2: Sterling Stamos Never Advised the Sterling Partners Not to Invest with Madoff**

The Complaint alleges vociferously that Sterling Stamos personnel "warned" the Sterling Partners not to invest with Madoff and told them to withdraw all of their funds from BLMIS. The Sterling Defendants proved that no such statements were made. (Sterling Br. at 8-11.) In response, the Trustee relies on the same post-December 11, 2008 emails featured in his Complaint. (Trustee Opp. at 21-22 (citing Bohorquez Decl., Exs. 17, 18, 19).) Again, no evidence prior to December 11, 2008 corroborates these allegations, the Trustee never even asked Mr. Chachra about these emails, and the sworn testimony of Messrs. Stamos and Chachra is unequivocal: they never told the Sterling Partners to withdraw *all* of their funds from their BLMIS accounts and never thought Madoff was a fraud. (Sterling Br. at 8-11; Chachra Decl. ¶ 7.)

They did warn that if too much was concentrated with one investment manger, even the best manager, the impact of any adverse event would be magnified (Stamos Tr. 86:7-87:2; 89-1:9 (Seshens Decl., Ex. A)), and, thus, advised diversification. This was no warning of fraud.[6]

> "[T]here seems to be no reason to be worried about this capital [with BLMIS] being at risk. However, it's still concentration risk and there's still the possibility that [Madoff] could retire, there's still the possibility that he could be hit by a truck, there's still the possibility that he could have a regulatory review in which your assets are held up for a period of

[6] "Single-manager risk" has nothing to do with fraud. (Stamos Tr. 85:15-24 ("Q. And can you explain to me specifically what [single-manager risk] means? A. I can explain it generally. Q. That's fine. A. Generally, the notion of portfolio construction would suggest that one ought to put their investments into a diversified portfolio of managers, not into a single manager. As a rough rule of thumb, no more than 10 percent in any one manager.") (Seshens Decl., Ex. A).)

> time. And for, again, those reasons I wouldn't put more than 10 percent of my assets in any one manager. But I put it in the same category as an investment with any other investment manager like Mr. Madoff, such as D.E. Shaw or any other similarly situated manager." (*Id.* 147:6-148:2.)

As in other instances, the Trustee appears to challenge the credibility of Peter Stamos' testimony. Here, he quotes additional testimony he says is inconsistent—but he critically alters the quote by omitting the italicized language below. Consequently, a "yes" answer appears to respond to a different question than it actually did. Once corrected, the testimony is consistent with the rest of Mr. Stamos' evidence that no fraud warning was given—only counsel on diversification:

> "Q. So you never recommended to Saul Katz to withdraw his money from Madoff?
>
> A. To be clear, recommended is the word that I'm pausing on. Did I suggest him to do that? Yes. Did I ask him to do that? Yes. But recommendation would assume that I had an investment recommendation about the fund and I didn't have—I couldn't make an investment recommendation about that fund. It was not under our purview.
>
> Q. Okay. So putting aside the term of art of recommendation, you suggested to him or you asked him to withdraw money from Madoff?
>
> *A. It's important, the distinction.*
>
> *Q. No, I understand that. That's why I'm drawing it.*
>
> A. Yes.
>
> Q. . . . Did anyone at Sterling Stamos ever recommend to anyone at Sterling that they should, that Sterling should withdraw its assets from Madoff?
>
> A. I don't know if anyone, in the way I use the word 'recommend,' formal, professional advice, did that. I believe that on a regular basis Mr. Chachra, who was assigned to Mr. Katz's account, encouraged him to diversify from Madoff and put more capital with us. But I say that in the context of competition. We wanted more of his capital, and we believed that whether it was Bernard Madoff or D.E. Shaw or Paul Singer or any

other great hedge fund manager, you shouldn't put more than 10 percent with that manager, whoever he or she was." (*Id.* 164:12-165:17 (emphasis added).)

**Uncontroverted Fact #3: The Sterling Partners Had No Special Expertise That Enabled Them to Discover Madoff's Fraud**

The Trustee must prove that the Sterling Defendants were participants in Madoff's fraud. He claims that their exposure to Sterling Stamos made them sufficiently expert in the stock market and in hedge fund due diligence that they *must* have known what their trusted friend and advisor was up to. Based on this supposed expertise, the Trustee imposes upon them a duty to unravel a fraud undetected by scores of real market professionals and by regulatory agencies. The law does not support this proposition. But the Trustee in any event cannot controvert the evidence that no Sterling Defendant was a market expert.

First, every Sterling witness testified to his lack of stock market sophistication. (Sterling Br. at 11-12.) The Trustee responds by arguing that Fred Wilpon *did* have market expertise (Rule 56.1 Response[7] ¶ 52), just not sufficient expertise to have understood Madoff to be a "guru" who was "renowned in the investment field" (*id.* ¶ 12). All evidence is contrary to the Trustee's first contention, and his second is inapposite. Mr. Wilpon is not being offered as a "guru" expert—his testimony is simply that he understood, based on what he had been told and believed, that Madoff was a "guru" in a field about which he knows nothing. Equally spurious is the contention that because Saul Katz was responsible for Sterling's finances and financial strategy he must be a

[7] Citations to "Rule 56.1 Response" pertain to the Trustee's Response to the Sterling Defendants' Statement of Material Facts Pursuant to Local Rule 7056-1, May 19, 2011.

sophisticated stock market investor (*id.* ¶ 51)—Mr. Katz did not make market decisions and had no experience to do so; he left that to Madoff.

Second, every Sterling *and* Sterling Stamos witness testified to the total lack of involvement of any Sterling Partner in the investment business of Sterling Stamos. (Sterling Br. at 12-17.) Any contention that either Saul Katz or David Katz had any involvement in its investment decisions has been squarely refuted. (*See, e.g.*, Stamos Tr. 137:8-138:13 (Saul Katz's Sterling Stamos involvement included providing capital and making business decisions) (Seshens Decl., Ex. A); Chachra Tr. 133:22-134:3 (Saul Katz "was not involved *at all* in the investment decision-making") (emphasis added); 124:5-10 (none of Saul Katz, David Katz, or Fred Wilpon had "*anything* to do with the investments of Sterling Stamos") (Seshens Decl., Ex. C).)

In an attempt to refute this evidence, the Trustee again relies on unauthenticated emails and inadmissible hearsay to argue that the witnesses' sworn testimony is not credible. (Rule 56.1 Response ¶¶ 51-52, 54-55; Bohorquez Decl., Exs. 10, 11, 12, 14.) He claims that one such email proves that Saul Katz and David Katz were members of the Sterling Stamos "Investment Committee" in August 2004. (Rule 56.1 Response ¶¶ 3, 57-59, 61; Bohorquez Decl., Ex. 10.) But no testimony by the author of the email is offered, nor is the hearsay it contains admissible.[8] It is therefore incompetent to raise a

[8] Equally inadmissible are a February 2005 "hedge fund questionnaire" and February 2005 set of marketing materials that appear to claim investment committee membership for Saul and David Katz and to designate them as "two of the four 'primary portfolio decision makers'" at Sterling Stamos at that time. (Rule 56.1 Response ¶ 3, 57, 59, 61; Bohorquez Decl., Exs. 11, 12.) The Trustee has introduced no evidence as to what these documents are, who prepared them, for what purpose, if any, they were used, and whether they even were provided to third-party potential investors. The "hedge fund questionnaire" on its face appears to be an incomplete draft (Bohorquez Decl., Ex. 11 at 6-8), seemingly drafted by DeMarche Associates, Inc., an investment research firm that appears to be seeking, not confirming, the statements in

fact or credibility dispute, and its substance has been squarely refuted. (Sterling Br. at 13-17; *supra* at 19.)

Finally, both Saul Katz and David Katz testified to their respective lack of familiarity with Sterling Stamos' due diligence process. (Sterling Br. at 18-20.) There is no credible or admissible evidence to refute this testimony. The inadmissible hearsay statements in the Sterling Stamos marketing materials on which the Trustee relies have been rejected as "marketing puffery." (Sterling Br. at 12 n.2 (citing Stamos Tr. 167:18-25 (Seshens Decl., Ex. A)); *see also* Stamos Tr. 168:14-169:2 (Seshens Decl, Ex. A).) Inadmissible documentary evidence that is refuted by sworn testimony cannot create a material factual dispute. *See Harvey v. Wal-Mart La. L.L.C.*, 3:06-CV-02389, 2009 U.S. Dist. LEXIS 90745, at *48 (W.D. La. Sept. 30, 2009) (granting summary judgment where inadmissible documentary evidence was explained by witness's uncontroverted testimony); *Haerting v. One Tucan Du, Inc.*, Civ. No. 94-142, 1995 U.S. Dist. LEXIS 18923, at *20 (E.D. La. Dec. 19, 1995) (granting defendant judgment as a matter of law where the "terms and overall context" of the memorandum upon which plaintiff's case relied, "as explained by [defendant's testimony], ma[de] it clear that neither an inference of fraudulent intent" nor any other required inference could reasonably be based on the document); *see also* S.D.N.Y. Local Rule 56.1(d) ("Each statement by the movant or opponent pursuant to Rule 56.1(a) and (b), including each statement controverting any statement of material fact, must be followed by citation to evidence which would be admissible[.]"); S.D.N.Y. Bankr. Local Rule 56.1(e) (same).

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the document. *See generally* DeMarche Associates, http://www.demarche.com/default.asp. And, as noted, the substance of these documents has been refuted.

**Uncontroverted Fact #4: Neither Sterling Stamos Nor Merrill Lynch Did Due Diligence on BLMIS, and Its Black Box Strategy Was Not an Indication of Fraud**

Repeating false allegations in his Complaint, the Trustee contends in his opposition brief that BLMIS failed both Sterling Stamos' and Merrill Lynch's due diligence examinations, either because fraud was discovered or because the very nature of the BLMIS business reflected fraud. No such due diligence was undertaken. (Sterling Br. at 21-23; Chachra Decl. ¶¶ 6, 8.)

The Sterling Defendants demonstrated that both Sterling Stamos and Merrill Lynch had decided, independent of any consideration, let alone examination, of BLMIS, that they would not put customer funds into an investment strategy that was not transparent. (Sterling Br. at 20-24.) Therefore, neither would put customer funds into BLMIS and neither needed to do any due diligence because they already knew what they needed to know—BLMIS' trading strategy was a "black box." Not a scintilla of evidence demonstrates that either thought that BLMIS, or black box strategies in general, were fraudulent. To the contrary, Peter Stamos testified that he would not invest his clients' money with BLMIS even though he believed Madoff to be an honest and honorable broker—his decision had nothing to do with any suspicion at all.

The Trustee has not refuted this evidence. The Trustee only points to the same post-December 11, 2008 emails on which he repeatedly relies. (Trustee Opp. at 21-22 (citing Bohorquez Decl., Exs. 18, 19).) Those emails are in fact consistent with the Sterling Defendants' evidence that neither Sterling Stamos nor Merrill would invest in a black box—but not because there was anything unlawful about a non-transparent strategy. And the testimony is clear that the self-serving hearsay statements suggesting

that Sterling Stamos had advised against Madoff were intended to distance Sterling Stamos from the Madoff disaster. (Stamos Tr. 227:19-228:12 (characterizing his language in Ex. 19 as "stretching it"); 207:14-208:6 (viewing Ashok Chachra's language in Ex. 18 as "marketing") (Seshens Decl., Ex. A).)[9] As demonstrated, the sworn statements of Messrs. Stamos and Chachra refute any suggestion that either questioned Madoff's legitimacy before his arrest.

As a matter of law these emails create no dispute of material fact, especially as not a shred of pre-December 11, 2008 evidence is offered to corroborate the Trustee's claim.[10] Nor is there any dispute that Madoff's proprietary strategy was no indicator of fraud. On the contrary, Peter Stamos testified that, although Sterling Stamos chose not to place customer funds into proprietary trading systems, they were perfectly legitimate strategies employed by legitimate managers such as D.E. Shaw. (Trustee Opp. at 17 (citing Stamos testimony); *see also* Sterling Br. at 24-25.) No evidence at all from Merrill Lynch is offered. The Trustee cannot show that the "black box" nature of Madoff's strategy was any indication of fraud—it was not.

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[9] Indeed, Ashok Chachra himself expressed in his December 13, 2008 email to Peter Stamos, on which the Trustee relies, that he was seeking to create some space between Sterling Stamos and Sterling Equities in the wake of the disclosure of Madoff's fraud. (Bohorquez Decl., Ex. 18 ("We may want to look into a more broad communication that put[s] distance between us and Sterling. . . . We need to turn this negative for Sterling into a positive due diligence update for the Stamos partners.").)

[10] The Trustee's contention that Sterling Stamos turned down the opportunity to invest with BLMIS more than six years ago, as reflected in another post-arrest email, is also unfounded. (Trustee Opp. at 22 (citing Bohorquez Decl., Ex. 18).) Mr. Chachra, the author of this email, was not asked about it at his deposition. He has declared that Sterling Stamos was never offered an opportunity to invest with Madoff. (Chachra Decl. ¶ 5; *see also id.* ¶ 6.) Mr. Stamos, who *was* asked about this email at his deposition, testified that it was not true. (Sterling Br. at 22.) And the Trustee does not dispute that Sterling Stamos, in its early days, *wanted* to invest with BLMIS. (*See id.* at 22 n.9; Rule 56.1 Response ¶ 74.)

**Uncontroverted Fact #5: Sterling Stamos Was Not Restructured to Evade SEC Scrutiny of Madoff**

The Trustee continues to argue that Sterling Stamos was restructured for the "sole purpose" of accommodating Madoff's "secrecy" requirements, claiming that the restructuring is clear evidence that the Sterling Partners would do whatever Madoff wanted and therefore must have known he was engaged in a Ponzi scheme. (Trustee Opp. at 13-16.)

The Trustee cannot refute undisputed evidence to the contrary. The Sterling Partners did not want to disclose otherwise private family investments and business relationships, including their BLMIS holdings, but that was not for Madoff's benefit; rather, it was for their own. (S. Katz Decl. ¶ 18.) Nor can the Trustee refute the evidence that the Sterling Partners were concerned about increased legal exposure to third-party Sterling Stamos investors. (*Id.* ¶ 17.) Instead, he claims that Peter Stamos' testimony "directly contradicts" Mr. Katz's declaration. (Trustee Opp. at 13 n.9.) On the contrary, Mr. Stamos understood Sterling's privacy and confidentiality concerns, even those attributed to Mr. Madoff, and refused to agree with the suggestion they were out of the ordinary.[11]

> "Q. [D]id you think it was [out of the ordinary] that Madoff had concerns with Saul Katz having to disclose his investments or business relationship with Madoff if Sterling Stamos were to register as [an investment] advisor?

* * *

[11] There is also nothing contradictory about Mr. Stamos' testimony and Mr. Katz's sworn statements about restructuring Sterling Stamos because of the Sterling Partners' concern over increased legal exposure to third-party investors. (Trustee Opp. at 13 n.9.) In fact, it is impossible for Mr. Stamos' silence on this point to have contradicted Mr. Katz's sworn statement at all.

A. I did not consider it out of the ordinary." (Stamos Tr. 125:7-23 (Seshens Decl., Ex. A).)

* * *

"Q. And did the fact that the nature of Mr. Madoff's investment business was, you said highly private, did that concern you in any way?

A. It was my understanding at that time that that was the nature of many hedge fund investors. The most exclusive, hard-to-get access to investors were, generally speaking, hard to get access to, highly private, highly confidential." (*Id.* at 129:2-9.)

**Uncontroverted Fact #6: Neither Sterling Stamos Nor the Sterling Partners Thought Madoff Was Front Running**

The Complaint made the misleading allegation that Peter Stamos discussed with Saul Katz rumors that Madoff was front running—implying this was a warning of fraud—but omitted the critical fact that Peter Stamos told Saul Katz he did not believe the rumors were true. The Sterling Defendants have offered conclusive proof that no Sterling Partner nor anyone at Sterling Stamos actually thought Madoff was front running. (Sterling Br. at 28-30.) The Trustee cannot dispute this proof, so he now argues that the mere fact of the discussion is enough to charge the Sterling Defendants with being complicit—no matter that they and Peter Stamos concluded Madoff was not front running, no matter that he was not, and no matter that the magazine articles upon which the Trustee relies were available to the regulators as well, who took no action.[12] (Trustee Opp. at 18-19.)

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[12] The Trustee's argument that Peter Stamos discussed with the Sterling Partners the "implications" if Madoff were front running is similarly without merit. (Trustee Opp. at 18.) When asked what he discussed with Saul Katz about those "implications," Mr. Stamos testified:

"I remember Mr. Katz explaining to me that he didn't believe that [they] were true, that Mr. Madoff had been reviewed regularly by the SEC, that he was one of the most reputable investors, that he'd known him for 25 years, that he was highly honest, highly

No issue of fact is raised by this argument, which conveniently results in proving complicity regardless of what a defendant does.[13] Rather, the argument exposes again the complete lack of foundation in the Trustee's Complaint—if the Sterling Defendants had believed Madoff was front running, they could not simultaneously have thought he was not trading and this too, therefore, renders the entire front running discussion irrelevant.

**Uncontroverted Fact #7: Madoff's Custody of Securities Was Not a "Red Flag"**

As the Sterling Defendants established, self-custody arrangements are not remarkable (Sterling Br. at 31), a proposition that the Trustee does not dispute.[14] To the extent that the Trustee is arguing that self-custodying or self-clearing arrangements are indicators of front running (Trustee Opp. at 18-19), the Sterling Defendants have proved that no Sterling or Sterling Stamos witness thought Madoff was front running—and of course he was not. (Sterling Br. at 28-30.) Any supposedly similar "warnings" from Kevin Dunleavy of Merrill Lynch are inadmissible as hearsay (Trustee Opp. at 25-26); the Trustee had the ability to obtain evidence from Mr. Dunleavy and either possesses

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honorable. And for those reasons he didn't believe it were true and he asked me what I [thought]." (Stamos Tr. 152:21-153-12 (Seshens Decl., Ex. A).)

[13] Even if the Sterling Partners or Peter Stamos had thought Madoff was front running (which they did not and which he was not), that could not constitute knowledge or willful blindness of the actual fraudulent conduct in which BLMIS was engaged—no trading at all. *Cf. Kirschner v. Bennett*, 648 F. Supp. 2d 525, 544-46 (S.D.N.Y. 2009) (rejecting aiding and abetting liability based on defendants' knowledge of a related fraudulent scheme with a shared "common objective" where plaintiff-trustee failed to show defendants' knowledge of the specific conduct that caused the harm).

[14] The SEC recently has published proposed amendments to rules for brokers who self-custody and self-clear, suggesting that the SEC does not consider those activities to be fraudulent. Broker-Dealer Reports, Exchange Act Release No. 34-64676 (June 16, 2011), *available at* http://www.sec.gov/rules/proposed/2011/34-64676.pdf (last visited June 20, 2011). And contrary to one of the Trustee's abandoned assertions, the SEC is proposing to ask brokers whether they provide customers with electronic access to account information, suggesting that a lack of electronic access is also no indicator of fraud. *Id.* at 71.

evidence that he has chosen not to use, presumably because it does not support his claims, or he chose not to obtain it.

**Uncontroverted Fact #8: Nothing That the Sterling Partners Knew About the Bayou Fraud Did or Should Have Constituted a Warning About Madoff's Fraud**

The Trustee repeatedly claims that *Sterling Stamos'* experience with the Bayou fraud should somehow have warned the *Sterling Defendants* that Madoff also was engaged in fraud. His theory is implausible and wholly unproven.

First, the two situations are not similar. Bayou was a hedge fund and Sterling Stamos a professional equity investor. BLMIS was *not* a hedge fund; it was a registered broker, regulated by the SEC and FINRA. The Sterling Defendants were not professional investors, being paid to advise others; they were brokerage customers investing in blue chip securities on the advice of a broker held in high esteem by everyone.

Second, there was no BLMIS "style drift." (Sterling Br. at 32-33.) Bayou involved a complete change in investment strategy—from investments in equities to investments in currency and commodities, coupled with an intended substantial increase in assets under management over a three-month period with a minimal increase in back office infrastructure personnel. (*Id.*) By contrast, the BLMIS "special investment" was a one-time, "short-term" investment opportunity that employed Madoff's split-strike conversion strategy with only a slight modification.[15] (*See id.*; Rule 56.1 Response ¶ 103.)

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[15] Contrary to the allegations in the Complaint criticizing the Sterling Partners for "never understand[ing]" Madoff's "special investment" strategy (Compl. ¶¶ 1042, 1044-1045), the Trustee now contends that the Sterling Partners had a clear understanding of the purportedly "dramatic" strategy change employed (Trustee Opp. at 29 n.31). As the undisputed evidence demonstrates, only Arthur Friedman had some understanding of the "special investment," albeit a limited one, based on his tracking of the

Third, there is no evidentiary basis for the Trustee's new claim that the Sterling Partners were told that Sterling Stamos redeemed its Bayou investment because Bayou lacked transparency. (Trustee Opp. at 27-28.) Not even the Bayou redemption memoranda relied upon by the Trustee—which there is no evidence that the Sterling Partners ever saw—reflects lack of transparency as a reason for the Bayou redemption.[16] (Bohorquez Decl., Exs. 34, 35.)

**Uncontroverted Fact #9: The Sterling Defendants Conducted Diligence on Madoff Even Though They Had No Obligation to Do So**

The Trustee excoriated the Sterling Defendants in no fewer than twenty-two paragraphs of his Complaint for failing to do any due diligence. The unrefuted evidence of the Sterling Partners is exactly to the opposite. (Sterling Br. at 34-38.) And, indeed, the Trustee now concedes that diligence *was* undertaken (Rule 56.1 Response ¶¶ 108-127 (providing no viable basis for any factual dispute))—not, of course, because the Sterling Defendants understood that they had any duty to do so or because they had any concerns about Madoff or their BLMIS investments.

investment on a regular basis, and he observed only a change in the options trading (Sterling Br. at 33), consistent with the Trustee's allegations (Compl. ¶ 1044). That, by definition, is not a "style drift." Indeed, as Fred Wilpon testified, "Bernie never changed his strategy one iota all the time we were investors." (Wilpon Tr. 196:13-197:9 (Seshens Supp. Decl., Ex. Y).)

[16] The Trustee cites to the testimony of Fred Wilpon as support for his claim that lack of transparency was a reason that Sterling Stamos redeemed its Bayou investment. (Trustee Opp. at 28 n.27.) But it is apparent that Mr. Wilpon is speaking instead about style drift. (Wilpon Tr. 158:4-24 ("Q. What do you understand that concept to be, the lack of transparency, what's your understanding of that? A. That if someone said they were going to invest in widgets, and they invested in widgets, that was what they were supposed to do. But then all of a sudden they invested in widgets and water, or something else, they were going out of their strategy, that the people at Sterling Stamos would object to that, because they only wanted to invest with them if this was their strategy. Q. So your understanding of the lack of transparency concept is when a fund diverts from the initial strategy? . . . A. Yes.") (Seshens Supp. Decl., Ex. Y).)

But, the Trustee contends, because it was done in the 1980s, the diligence was not enough.[17] (Trustee Opp. at 33-35.) Thus, he not only seeks to impose upon brokerage customers a duty to investigate their broker—still failing to explain how a trustee standing in BLMIS' shoes could possibly have standing to assert any breach of this mythical duty—but he also imposes a standard that can never be met. Even once a customer has satisfied himself, he must be on the alert for any scrap of information that might cast aspersions on his broker or risk being hit with an unjustified one billion dollar lawsuit. No material dispute of fact is raised by the Trustee's lack of evidence or this legally unsupportable theory.

**Uncontroverted Fact #10: The Sterling Defendants Did Not Receive "Staggering" Profits**

The Trustee offers no evidence to support the widely touted claim that the Sterling Defendants received "staggering" profits; indeed, the Trustee did not even allege that the Sterling Defendants received "fantastical" or extraordinary returns. He does not suggest, nor could he, that their returns were any different from those of every other split-strike customer. In fact, all the Trustee contends is that, like every other split-strike customer, the Sterling Defendants received "consistent" or "steady" returns. (Sterling Br. at 39.)

[17] Entirely baseless is the Trustee's mantra, repeated throughout his opposition brief, that the Sterling Defendants affirmatively decided not to engage in due diligence of BLMIS because "they knew that violating [Madoff's] veil of confidentiality and secrecy would jeopardize their ability to continue investing with him" due to the perceived risk that, if they "threatened" Madoff with due diligence questions, "they would be barred from investing in BLMIS." (Trustee Opp. at 33.) This contention is completely contrary to another false claim—that the Sterling Defendants were so close to Madoff they could ask him anything. (*See, e.g.*, Compl. ¶ 740.) There is no evidence, nor does the Trustee offer any, to support the Trustee's contention, which is, in any event, contrary to the undisputed evidence that the Sterling Defendants had no need to ask due diligence questions because they were satisfied that Madoff was a trustworthy broker.

In fact, as the testimony demonstrates, the Sterling Defendants were willing to give up high returns in order to achieve consistency, which is exactly what Madoff marketed. His strategy called for investing in blue chip securities and collaring those investments with puts and calls to limit upside gain and downside exposure. The account statements he issued on a monthly basis to all customers, including the Sterling Defendants, demonstrated how he executed that strategy. (Seshens Supp. Decl., Ex. Z.) The Sterling Defendants were not in a position to evaluate whether the strategy was valid, and the efforts they did make demonstrated to their satisfaction that it was consistent with the market. Other split-strike customers, and BLMIS' regulators, reached the same conclusion. Finally, consistent returns alone are no indication of fraud. Indeed, Peter Stamos told Saul Katz consistency was something Sterling Stamos looked for when evaluating fund managers. (Stamos Tr. 205:6-11 (Seshens Decl., Ex. A); Rule 56.1 Response ¶ 135.)

**The Remaining Allegations Are Immaterial and Irrelevant and the Trustee Has Failed to Refute the Sterling Defendants' Evidence**

The Sterling Defendants have challenged the remainder of the allegations in the Trustee's Complaint as either false, immaterial, or irrelevant to establishing that the Sterling Defendants were complicit in Madoff's fraud. (*See* Sterling Br. at 40-47.) The Trustee has failed to dispute many of these challenges, and in no case has he raised any disputed issue of material fact that precludes granting summary judgment in the Sterling Defendants' favor.

**Several Allegations Are Completely Abandoned**

The Trustee has abandoned allegations concerning the publicly known "red flags" (*see, e.g.*, Compl. ¶¶ 929-930, 933-936, 1058), Ivy Asset Management (*id.* ¶¶ 917-919), the Brooklyn College Foundation (*id.* ¶¶ 922-924), Madoff's strategy (*see, e.g.*, *id.* ¶¶ 835-837, 869, 1047, 1075, 1079), the Katz and Wilpon Family Foundations trying to help Madoff "evade scrutiny" by the New York Attorney General's office (*id.* ¶¶ 1007-1015), and the Sterling Equities restructuring agreements (*id.* ¶¶ 853-864).

The Sterling Defendants, therefore, are entitled to summary judgment with respect to these supposed "red flags" to which the Sterling Defendants allegedly were "willfully blind," as their arguments are uncontested and, thus, conceded. *See, e.g.*, *Dorchester Investors v. Peak Trends Trust*, 99 Civ. 4696, 2003 U.S. Dist. LEXIS 1446, at *5 (S.D.N.Y. Feb. 3, 2003) (plaintiff's failure to address defendant's argument in its opposition papers means the argument "must be taken to be conceded"); *Dubai Islamic Bank v. Citibank, N.A.*, 126 F. Supp. 2d 659, 670-71 (S.D.N.Y. 2000) (defendant's argument implicitly conceded because plaintiff's opposition brief "[did] not (adequately) address" the argument); *Anti-Monopoly, Inc. v. Hasbro, Inc.*, 958 F. Supp. 895, 907 n.11 (S.D.N.Y. 1997) ("[T]he failure to provide argument on a point at issue constitutes abandonment of the issue."), *aff'd*, 130 F.3d 1101 (2d Cir. 1997).

**The Remaining Allegations Are Inconsequential**

None of the other allegations in the Complaint is material or supportable.

First, the Trustee's Complaint makes reference to a "Sterling consultant" who allegedly told Peter Stamos in an undated email that he had "warned Saul Katz about Madoff's inexplicable returns" and "couldn't make Bernie's math work and something

wasn't right." (Compl. ¶¶ 920-921.) The Trustee's opposition brief reveals that the consultant was Tim Dick, an energy and conservation consultant, who sent a December 13, 2008 email to Peter Stamos reflecting the language quoted above. (Trustee Opp. at 26; Bohorquez Decl., Ex. 32.) The Trustee has introduced no evidence from Mr. Dick, nor any admissible evidence from anyone else, about this email which contains inadmissible hearsay. Mr. Stamos, when questioned about Mr. Dick's supposed discussion concerning Madoff, knew nothing about it. (*See, e.g.*, Stamos Tr. 247:6-249:4; 314:8-14 (Seshens Decl., Ex. A).) David Katz did not even know who Tim Dick was (D. Katz Tr. 155:24-156:2 (Seshens Supp. Decl., Ex. V)), and Saul Katz was never asked about Mr. Dick or this alleged conversation and has no recollection of it taking place (S. Katz. Decl. ¶ 15).

Second, the Trustee continues to claim that the Sterling Partners worked to help Madoff "evade scrutiny" by structuring their 401(k) Retirement Plan as participant-directed rather than trustee-directed.[18] (Rule 56.1 Response ¶¶ 141-143; *see also* Sterling Br. at 44-45.) The Trustee's theory, again, defies common sense. If the Sterling Partners had wanted to prevent scrutiny of Madoff, why would they have permitted the Plan, which itself is subject to regulatory scrutiny, to become a BLMIS customer?

The Trustee's claim is also contradicted by the evidence. Sterling elected to structure its employee retirement plan as a participant-directed plan because it was more popular and would reduce Sterling's fiduciary exposure. (Friedman Tr. 561:12-24

[18] The Trustee also contends that the Sterling Partners "screened" friends and family customers so as to protect Madoff. There is no evidence to support this claim. (Sterling Br. at 45; Rule 56.1 Response ¶¶ 24-25.)

(Seshens Decl., Ex. H).) The Trustee refers to handwritten notes taken by Arthur Friedman which read, in relevant part, "everyone will ask and know about BM" in the context of a trustee-directed plan. (Bohorquez Decl., Ex. 58.) But Mr. Friedman was asked about these notes and testified that there was no concern that employees would "ask and know" about Madoff:

> "Q. Was it a concern on your part that people would, employees would ask and know about Bernie Madoff?
>
> A. No, I don't . . .
>
> Q. You don't recall ever being encouraged to keep Madoff kind of a well-kept secret?
>
> A. No.
>
> Q. Do you recall any discussion about that point at this meeting, that everyone will ask and know about Madoff?
>
> A. No, I don't recall any such concern or discussion." (Friedman Tr. 562:11-23 (Seshens Supp. Decl., Ex. U).)

Finally, there are the Trustee's insinuations about a document relating to a $54 million bridge loan from Madoff. (Trustee Opp. at 35-37.) There is no dispute as to the facts giving rise to the loan or that the loan was made and repaid almost instantly. (Rule 56.1 Response ¶¶ 147-150.) There is no claim that anyone was defrauded by the transaction or by an agreement to agree that appears to have been related. (Sterling Br. at 45-47.) Nevertheless, the Trustee deems this one-page document evidence of the Sterling Defendants' "see no evil" approach to Madoff and their willingness to "execut[e] a sham transaction" with him and seeks "substantial discovery on a variety of issues, including the financing transactions that were involved and the motivation underlying the need for the sham 'investment.'" (Trustee Opp. at 35-37.)

But the Trustee deposed at length the two principal Sterling Partners involved, requested and obtained a proffer, in lieu of testimony, from another, and was given every related document that could be found. (Seshens Supp. Decl. ¶¶ 9-11.) At least one of Sterling's banks produced responsive documents (Bohorquez Decl. ¶¶ 26, 28), and presumably could have been deposed. There is no more discovery to be had. The Trustee has examined everyone and everything. He has found nothing. That does not create any dispute of material fact; indeed, it demonstrates that there is none.

## ARGUMENT

### I. THE TRUSTEE HAS FAILED TO RAISE ANY TRIABLE ISSUE OF MATERIAL FACT AS TO THE STERLING DEFENDANTS' COMPLICITY IN MADOFF'S FRAUD

A party is entitled to summary judgment where "no genuine dispute as to any material fact" exists and the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a); *Fed. Ins. Co. v. Am. Home Assurance Co.*, 639 F.3d 557, 566 (2d Cir. 2011). To defeat summary judgment, the Trustee must put forward probative evidence to contradict that put forth by the Sterling Defendants. *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986).

Evidence that is "merely colorable" or that "is not significantly probative" is insufficient to raise a genuine issue requiring trial, *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249-50 (1986), as are implausible claims based on mere speculation, *Brady v. Colchester*, 863 F.2d 205, 211 (2d Cir. 1988). Summary judgment must be granted against a plaintiff who fails to offer "concrete evidence from which a reasonable juror could return a verdict in his favor." *Liberty Lobby*, 477 U.S. at 256; *accord Greenwood*

*v. Koven*, 880 F. Supp. 186, 202-03 (S.D.N.Y. 1995) (granting summary judgment where requisite inference was unbelievable).

Further, inadmissible evidence cannot raise a dispute as to any material fact. *See, e.g.*, *Estate of Hamilton v. City of New York*, 627 F.3d 50, 53 (2d Cir. 2010) ("[T]he district court in awarding summary judgment[] may rely only on admissible evidence."); *Barua v. Credit Lyonnais-U.S. Branches*, 97 Civ. 7991, 1998 U.S. Dist. LEXIS 20338, at *10 (S.D.N.Y. Dec. 30, 1998) (awarding summary judgment for defendant where "much of plaintiff's proffered 'evidence' [was] either inadmissible hearsay or so conclusory as to fail to satisfy the requirements of Rule 56(e)"); *see also* S.D.N.Y. Local Rule 56.1(d) (requiring citation to admissible evidence in effort to controvert any statement of material fact); S.D.N.Y. Bankr. Local Rule 56.1(e) (same). A fact that is not demonstrably disputed by admissible evidence is deemed to be admitted. *Emigra Group, LLC v. Fragomen, Del Rey, Bernsen & Loewy, LLP*, 612 F. Supp. 2d 330, 347-48 (S.D.N.Y. 2009).

The Sterling Defendants exposed the lack of foundation for the Trustee's Complaint with evidence—largely adduced by the Trustee himself. The Trustee has failed to "debunk" any of that evidence. Instead, in the face of that evidence, the Trustee has persisted in putting forward false and misleading allegations supported solely by inadmissible hearsay contained in self-serving, post-arrest emails that are uncorroborated by any pre-arrest evidence and that are inconsistent with sworn testimony. These emails are insufficient as a matter of law to controvert the Sterling Defendants' evidence. They even fail to suggest that anyone at Sterling Stamos or elsewhere thought, let alone communicated to any Sterling Defendant, that Madoff was engaged in fraud. *All* of the

Sterling Stamos and Sterling testimony is to the contrary, consistent with the dearth of pre-December 11, 2008 corroborative evidence.

Nor can the Trustee carry his burden by trying to attack the credibility of the Sterling Stamos or Sterling witnesses, including witnesses on whom the Trustee himself relies. (Trustee Opp. at 21 n.20, 40, 41.) The Trustee actually suggests that the Court should not credit the "self-serving unexamined testimony" from Saul Katz and Ashok Chachra—even though he examined both declarants under oath.[19] (Rule 56.1 Response at 2 n.1.) The testimony of both is consistent with their deposition testimony; their statements simply provide answers to material questions that the Trustee failed to ask. And the Trustee actually relies on Mr. Chachra's deposition testimony (Bohorquez Decl., Ex. 31), even though the purported bases for his credibility attack existed when Mr. Chachra was deposed.

Accordingly, the Trustee has failed to raise any dispute of material fact by his unfounded credibility attacks. *See, e.g.*, *Fernandez v. China Ocean Shipping Co.*, 312 F. Supp. 2d 369, 378 (E.D.N.Y. 2003) ("Merely to assert that a witness may be lying, without any evidence to contradict the witnesses' testimony cannot defeat a motion for summary judgment." (internal citations and quotation marks omitted)); *County of Orange v. Sullivan Highway Prods., Inc.*, 752 F. Supp. 643, 647 (S.D.N.Y. 1990) (granting summary judgment and holding that "[t]here must . . . be more than mere allegations in a

[19] The Trustee remarkably relies on two wholly inapposite cases that provide no support for his counsel to the Court. *See Madeira v. United Talmudical Acad. of Kiryas Joel*, 351 F. Supp. 2d 162, 167 (S.D.N.Y. 2004) (stating, in dicta, that where the affidavit of defendant was the sole piece of evidence, it could not be a basis for summary judgment where declarant *never had been deposed*); *E-Smart Techs., Inc. v. Corse*, 03 Civ. 7060, 2004 WL 2093531, at *3 (S.D.N.Y. Sept. 17, 2004) (denying summary judgment on breach of fiduciary duty claim where *only* evidence submitted was defendant's declaration that he was not a company officer and, thus, owed no fiduciary duty).

memorandum of law to place credibility in issue and preclude summary judgment; specific facts must be produced" (internal quotation marks omitted)).

## II. THE TRUSTEE'S REQUEST FOR ADDITIONAL DISCOVERY IS MERITLESS

On December 7, 2010, the Trustee filed his first complaint against the Sterling Defendants. The complaint contained 1365 paragraphs and reflected the names of fourteen lawyers. These lawyers had by then taken a vast amount of discovery pursuant to Bankruptcy Rule 2004. On March 18, 2011, under the aegis of the same fourteen lawyers the Trustee filed an amended complaint containing 1402 paragraphs. The Complaint restates all of the original false allegations and makes new ones. Now, in his opposition to the Sterling Motion, the Trustee has yet again embroidered on his claims.

The Trustee insists that he has "evidence" for all of these allegations—indeed an "array" of "ample" evidence. (Trustee Opp. at 2, 4, 5.) And he certainly has had the opportunity to obtain such evidence. He has had unfettered access to every person with knowledge of or access to any material information and has engaged in a sweeping and unilateral "fishing expedition" pursuant to Bankruptcy Rule 2004 that would not be permissible in adversary litigation. The Trustee has relied on this extensive discovery record to respond to the Sterling Defendants' motion. Now, the Trustee also contends that summary judgment cannot be awarded to the Sterling Defendants because he needs even *more* discovery, although he has failed to comply in any respect with the requirements of Rule 7056(d). His contention is plainly wrong and cannot defeat the Sterling Motion.

### A. The Trustee Took Sweeping Discovery as Part of His Bankruptcy Rule 2004 Fishing Expedition

On October 7, 2009, the Trustee issued two sweeping Rule 2004 subpoenas to the Sterling Defendants, which ultimately were combined into a single broad demand. The Sterling Defendants produced nearly 700,000 pages of documents over a 14-month period. At no time did the Sterling Defendants refuse to provide non-privileged responsive documents, and at no time did the Trustee seek judicial intervention to compel any response—to his subpoena or to any of his additional requests. (Seshens Supp. Decl. ¶¶ 6(c), 7(j).) In addition, every Sterling witness requested for deposition by the Trustee was made available, including Fred Wilpon and Saul Katz. (*Id.* ¶ 8(a).) Sterling counsel placed no time or subject matter limitations on those depositions. (*Id.* ¶ 8(b).)

The Trustee now argues that all of this discovery does not really count, and that he should be entitled to start over before the *bona fides* of his Complaint are tested.

The Trustee is wrong. Discovery under Rule 2004 is, if anything, far more sweeping than discovery under the adversary rules. *See, e.g.*, *In re Recoton Corp.*, 307 B.R. 751, 755 (Bankr. S.D.N.Y. 2004) (observing that the scope of Rule 2004 discovery is "very broad, broader even than discovery under the Federal Rules of Civil Procedure" and that the Federal Rules provide "greater protections" than Rule 2004); *In re Enron Corp.*, 281 B.R. 836, 840-41 (Bankr. S.D.N.Y. 2002) (distinguishing between "the broad nature of the Rule 2004 exam and the more restrictive nature of discovery under the Federal Rules of Civil Procedure" (internal quotation marks and alterations omitted)).

Evidence adduced under Rule 2004 also is just as probative as evidence adduced under the adversary rules and provides an entirely adequate basis for summary judgment.

*See In re Vanderveer Estates Holding, LLC*, 328 B.R. 18, 29-30 (Bankr. E.D.N.Y. 2005) (granting defendant summary judgment and rejecting plaintiff's Rule 56 application for additional discovery because plaintiff "could have sought [the] discovery pursuant to Bankruptcy Rule 2004 at any time after commencement of the bankruptcy case"); *In re Roebas*, No. 05-11637-RGM, 2006 Bankr. LEXIS 2811, at *3 (Bankr. E.D. Va. Feb. 23, 2006) (granting summary judgment for defendant because Rule 2004 discovery provided plaintiff with "ample opportunity" to develop facts to oppose defendant's motion, yet plaintiff failed to come forward with evidence creating a genuine issue of material fact); *see also In re Old Carco LLC*, 435 B.R. 169, 192 (Bankr. S.D.N.Y. 2010) (liquidation trust required to meet particularized pleading standard because of "ample opportunity" to investigate claims through Rule 2004 pre-complaint discovery that yielded access to numerous documents and depositions); *In re Howard*, No. 09-22557, 2009 Bankr. LEXIS 3743, at *18 (Bankr. S.D.N.Y. Nov. 25, 2009) (rejecting defense to deficient complaint that plaintiff was "largely in the dark" about defendant's conduct because plaintiff had "ample time to take free ranging discovery under [Rule] 2004 before filing its complaint").

### B. The Trustee Has Failed to Demonstrate Any Basis for Additional Discovery under Bankruptcy Rule 7056(d)

To avoid the issuance of summary judgment for the Sterling Defendants, the Trustee seeks additional discovery pursuant to Federal Rule of Civil Procedure 56(d), applicable in bankruptcy cases through Bankruptcy Rule 7056.[20]

[20] The Federal Rules of Civil Procedure were amended in 2010, which altered the structure of Rule 56 so that prior Rule 56(f) became current Rule 56(d). There was no substantive change to the rule as part of these amendments. *See* Fed. R. Civ. P. 56 advisory committee note ("Subdivision (d) carries

Because the Trustee has responded to the Sterling Defendants' motion and claims to have ample evidence with which to do so, he cannot now demand more discovery under Rule 7056. *See N.Y. State Teamsters Conference Pension & Ret. Fund v. Express Servs., Inc.*, 426 F.3d 640, 648 (2d Cir. 2005) ("[A] party's failure to seek discovery under Rule [56(d)] before responding to a summary judgment motion is itself sufficient grounds to reject a claim that the opportunity for discovery was inadequate." (internal quotation marks omitted)); *see also Van Oss v. New York*, 10 Civ. 7524, 2011 U.S. Dist. LEXIS 44150, at *34-35 (S.D.N.Y. April 25, 2011); *Laurent v. PricewaterhouseCoopers LLP*, 06 CV 2280, 2009 U.S. Dist. LEXIS 25946, at *1-2 (S.D.N.Y. Mar. 27, 2009).

Unlike Bankruptcy Rule 2004, Rule 56(d) does not contemplate an unfocused "fishing expedition" in search of hoped for, but unspecified, facts. *See Sahu v. Union Carbide Corp.*, 262 F.R.D. 308, 312-13 (S.D.N.Y. 2009); *see also Am. Home Assurance Co. v. Jamaica*, 418 F. Supp. 2d 537, 546-49 (S.D.N.Y. 2006) (reviewing Second Circuit's Rule 56 discovery jurisprudence). Pursuant to Rule 56(d), the Trustee must demonstrate to the Court "by affidavit or declaration that, for specified reasons, [the Trustee] cannot present facts essential to justify its opposition." The requisite affidavit or declaration must specify:

> "(1) what facts are sought [to resist the motion] and how they are to be obtained, (2) how those facts are reasonably expected to create a genuine issue of material fact, (3) what effort affiant has made to obtain them, and (4) why the affiant was unsuccessful in those efforts." *Gurary v. Winehouse*, 190 F.3d 37, 43 (2d Cir. 1999) (internal quotation marks omitted).

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forward without substantial change the provisions of former subdivision (f)."); *see also Livingston v. Kelly*, No. 10-2022, 2011 WL 2006882, at *3 (2d Cir. May 24, 2011) (explaining that Rule 56(f) is "now recodified" as Rule 56(d)).

The Trustee has failed even to submit a Rule 56(d) affidavit, which, alone, precludes any request for additional discovery. *See Di Benedetto v. Pan Am World Serv., Inc.*, 359 F.3d 627, 630 (2d Cir. 2004) (failure to submit Rule 56 affidavit is grounds to deny discovery request); *Bussey v. Phillips*, 419 F. Supp. 2d 569, 591 (S.D.N.Y. 2006) ("It is well settled in this Circuit that a motion for further discovery under Rule [56(d)] may not be granted unless the moving party submits an affidavit satisfactorily explaining [the *Gurary* criteria]."). The Trustee does ask that the Bohorquez Declaration and accompanying exhibits be considered the "functional equivalent" of a Rule 56(d) affidavit. (Trustee Opp. at 48 n.49.) But the Bohorquez Declaration does not comply with Rule 56 or the *Gurary* criteria. *See Burlington Coat Factory Warehouse Corp. v. Esprit de Corp.*, 769 F.2d 919, 926-27 (2d Cir. 1985) (affirming denial of request for Rule 56 discovery for failure to satisfy *Gurary* criteria). The Trustee's reliance on *Reed v. Staniero*, 06-CV-3496, 2007 WL 3430935, at *7 (D.N.J. Nov. 13, 2007), a *pro se* case providing that the standards for a Rule 56 affidavit are "less stringent" when "discovery is *yet to begin*," is entirely misplaced. (Trustee Opp. at 48 n.49 (emphasis added).)

First, the Bohorquez Declaration fails to "identify specific issues of material fact which are *likely* to be disclosed" by additional discovery. *210 E. 86th St. Corp. v. Combustion Eng'g, Inc.*, 821 F. Supp. 125, 144 (S.D.N.Y. 1993); *see also Wright v. Eastman Kodak Co.*, 328 Fed. App'x 738, 739 (2d Cir. 2009) (denying further discovery when plaintiffs "were vague both in their description of requested documents and in their explanations of how those documents and/or requested deposition testimony would satisfy their burden of demonstrating a genuine dispute of material fact"); *Desclafani v. Pave-Mark Corp.*, 07 Civ. 4639, 2008 U.S. Dist. LEXIS 64672, at *27-28 (S.D.N.Y.

Aug. 22, 2008) (denying Rule 56 discovery request because, among other reasons, plaintiff "utterly fails to explain how the facts sought are reasonably expected to raise a genuine issue of material fact").

Second, the Bohorquez Declaration fails to explain why the Trustee has "reason to believe" that the Sterling Defendants and various third parties "have within their possession, custody or control additional information relevant to the claims and defenses in this matter" or what that relevant information is. (*Id.* ¶¶ 25 (Sterling Defendants), 27 (Sterling Stamos), 28 (Bank of America), 30 (Merrill Lynch), 32 (unidentified "additional non-parties and individuals").) It is no substitute for a Rule 56(d) affidavit. Where the Trustee has wielded Rule 2004 to obtain every witness and every document he demanded, he cannot successfully oppose summary judgment by claiming he has "reason to believe" that other unspecified evidence might be found in some unidentified place to support his case. *See, e.g.*, *Contemporary Mission, Inc. v. U.S. Postal Serv.*, 648 F.2d 97, 107 (2d Cir. 1981) ("Rule [56(d)] cannot be relied upon to defeat a summary judgment motion where the result of a continuance to obtain further information would be wholly speculative." (internal quotation marks omitted)); *210 E. 86th St. Corp.*, 821 F. Supp. at 144 (granting defendants summary judgment and rejecting request for Rule 56 discovery because, among other reasons, "Rule [56(d)] may not be used as means for prolonging an action when further discovery is based on mere speculation"); *see also, e.g.*, *Burgess v. Fairport Cent. Sch. Dist.*, 371 Fed. App'x 140, 142 (2d Cir. 2010) (denying request for Rule 56 discovery because it "was based solely on conjecture and speculation"); *Penguin Group (USA) Inc. v. Steinbeck*, 06 Civ. 2438, 2009 U.S. Dist. LEXIS 113068, at *8

(S.D.N.Y. Dec. 2, 2009) (denying defendants' request for Rule 56 discovery because they failed to "specifically allege what they hope to discover").[21]

Finally, the Trustee cannot credibly claim that he was unable to get critical discovery before opposing the Sterling Motion. *See Lerwick v. Kelsey*, 150 Fed. App'x 62, 65 (2d Cir. 2005) (denying Rule 56 discovery because plaintiff failed to explain how he was prevented from obtaining discovery and because his requests "appear[ed] to be more of a 'fishing expedition' than a good-faith effort to fill in evidentiary gaps"); *Burlington Coat Factory*, 769 F.2d at 926 (upholding denial of request for Rule 56 discovery because, among other reasons, there was "no reason to believe Burlington's [initial] discovery was not sufficient," as it "had deposed the principal actors for [defendant] and had received answers to its interrogatories and requests for documents from both defendants"); *Little v. City of N.Y.*, 487 F. Supp. 2d 426, 436 (S.D.N.Y. 2007) (denying further discovery because plaintiff could not show that he had been "stonewalled or prevented from conducting discovery").

Consequently, there is no basis for granting the Trustee more discovery to see if he can come up with something to validate his illegitimate Complaint. *See First Nat'l*

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[21] The Trustee's opposition brief and Rule 56.1 Response allude to some areas of desired inquiry. In each case, however, the Trustee already has had ample discovery, as for example, with regard to the $54 million bridge loan from Madoff in 2004. (*See supra* at 32-33.) The Trustee claims that he needs additional discovery to dispute that David Katz did not know that Ivy Asset Management ("Ivy") was a Madoff investor and that Saul Katz does not recall anyone from Ivy advising him of any concerns about Madoff. (Rule 56.1 Response ¶¶ 129, 130.) Both Saul and David Katz have been subjected to unrestricted examinations under oath and both have sworn to those statements. (D. Katz Tr. 155:19-22 (Seshens Supp. Decl., Ex. V); S. Katz Decl. ¶ 14.) Any communications concerning any warning about Madoff's or BLMIS' legitimacy from Ivy were called for by the Rule 2004 subpoenas to which the Sterling Defendants responded and, thus, would have been produced if they existed. (Seshens. Supp. Decl. ¶ 7(d).) And the Trustee has taken discovery of Ivy. Finally, the Trustee claims to need additional discovery to dispute the entirely immaterial fact that Saul Katz "occasionally," rather than daily, spoke with Madoff on the phone. (Rule 56.1 Response ¶ 19.) Saul Katz testified to this precise fact before the Trustee filed his Complaint. (S. Katz Tr. 77:7-19 (Seshens Decl., Ex. D).)

*Bank of Ariz. v. Cities Serv. Co.*, 391 U.S. 253, 297-99 (1968) (denying Rule 56 discovery because plaintiff had "failed, despite already substantial discovery, to obtain any significant evidence" supporting his claims and "additional discovery would [therefore] be futile"); *Van Oss*, 2011 U.S. Dist. LEXIS 44150, at *34-35 (concluding that Rule 56 discovery would be futile because plaintiffs were already aware of relevant facts and proposed further discovery would yield only cumulative discovery); *Crump v. QD3 Entm't, Inc.*, 10 Civ. 3564, 2011 U.S. Dist. LEXIS 14157, at *12-13 (S.D.N.Y. Feb. 3, 2011) (finding that Rule 56 discovery would be futile given "numerous undisputed facts" supporting defendants' position).

## III. THE COMPLAINT STATES NO CLAIM FOR AVOIDANCE

Just as the Trustee has failed to "debunk" the Sterling Defendants' charges that the factual allegations in the Complaint are false, the Trustee has failed to explain how his avoidance claims fit within any known body of law.

There is no statutory or case law support for the Trustee's claims. The Complaint targets transfers that discharged BLMIS' obligations to the Sterling Defendants as its customers, reflected on their brokerage statements. Because these payments discharged antecedent debt, they cannot, by definition, be avoided as fraudulent. Indeed, the Complaint alleges, correctly, that targeted transfers made within the 90-day preference period were made on account of antecedent debt. Because the payments within the preference period were exactly like the payments outside of the preference period, the Trustee cannot avoid them as fraudulent, unless he can prove that the obligations themselves were invalid because the Sterling Defendants were participants in the Ponzi scheme.

The evidence demonstrates that the Sterling Defendants were innocent victims, not participants in the fraud. Faced with this factual barrier to any argument that BLMIS' obligations were invalid, the Trustee and SIPC are compelled to transform the law. Thus, to permit the Trustee to avoid transfers that are outside of the preference period, but that discharged antecedent debt, SIPC and the Trustee claim that SIPA compels them to combine the equality goal of the preference power with the temporal sweep of the fraudulent conveyance power, thereby overriding the limitations on the Bankruptcy Code avoidance provisions.

Their reading of SIPA is unprecedented and unfounded and causes SIPA to conflict with the other securities laws and the Bankruptcy Code. SIPC and the Trustee rest their novel approach upon the claim that this is a Ponzi scheme case and that changes everything—legal protections afforded brokerage customers are eliminated, the scope of the Bankruptcy Code's fraudulent conveyance provisions are expanded, and strict liability is imposed on every victim of the broker's fraud.

But none of the applicable federal statutes, nor any state law, contains any Ponzi scheme exception. The Trustee's Complaint must be dismissed.

**A. No Claim for Avoidance of Transfers as Fraudulent Is Sustainable**

Neither the Trustee nor SIPC disputes the fact that a broker regulated by the SEC and FINRA, whose transactions are governed by federal and state securities laws, is obligated to its customers for the securities reflected on their statements. Nor do they deny that if a customer were to demand those securities, or their value, from his broker, an array of federal and state laws would require entry of judgment for the customer against the broker for the securities on his statement. Obviously, then, a withdrawal

consistent with the broker's obligations as reflected on customer statements discharges valid antecedent debt and may not, by definition, be avoided as fraudulent.

The Trustee and SIPC argue, in opposition, that this case is *sui generis*, and the usual rules must be modified. They contend that in *this* case, because Madoff concealed a very large fraud for a very long time—a fraud so complex that the Trustee and his counsel have charged SIPC hundreds of millions of dollars so far to unravel it—BLMIS has a legal defense, based on *its own fraud*, to its customers' claims. Therefore, in *this* case, the Trustee, standing in the shoes of BLMIS, can claw back from customers payments based on securities the customers thought they owned because in *this* case they *never* owned them. Instead, customers are owed only the net cash they put into BLMIS over the decades, which SIPC and the Trustee call "principal," and have "no defense" to the Trustee's claims for what they call "fictitious profit."

This remarkable conclusion rests on several propositions: that Ponzi schemes are subject to their own unique and "universal" rules, including a "Ponzi scheme presumption" that eliminates the need for statutory basis or analysis; that SIPA's "customer" definition changes in a Ponzi scheme case; that SIPA enlarges the avoidance powers of the Bankruptcy Code in a Ponzi scheme case; and that customers of a broker engaged in a Ponzi scheme are under a continuous duty to investigate whether the payments they receive from the broker are the product of fraud, and if they fail to investigate, they are guilty participants who lose everything they ever invested.

Each proposition is entirely without statutory or analytical foundation. If SIPC and the Trustee were correct, no customer could ever rely on a brokerage statement because no customer will know that his broker is engaging in a Ponzi scheme until it is

too late. And if he does find out, whether he withdraws his assets or not, he is liable. This is not the law.

### 1. Regulated Brokers Engaged in Ponzi Schemes Are Governed by the Same Laws as Lawful Brokers

The first argument put forward by the Trustee is that in a Ponzi scheme case, it is a "virtually universally accepted rule" that payments to investors that exceed their deposits are fraudulent transfers. (Trustee Opp. at 58.) Both the Trustee and SIPC contend that a "Ponzi scheme presumption" dictates that all transfers by a Ponzi schemer in excess of "principal" may be deemed fraudulent on their face and thus avoidable. (*Id.* at 58; SIPC Opp. at 25-26.)

These sweeping claims are not based on any SIPA or bankruptcy case involving payments to customers on account of obligations reflected on brokerage statements—there are no such cases. They are instead based on receivership cases applying state common law, non-SIPA cases involving equity investments, or SIPA cases addressing avoidance of transfers other than those based on customer statements.[22] The "Ponzi

[22] *See In re Bayou Group, LLC*, 362 B.R. 624, 626 (Bankr. S.D.N.Y. 2007) (non-SIPA case involving equity investors in a hedge fund); *Scholes v. Lehmann*, 56 F.3d 750, 752-53 (7th Cir. 1995) (receivership case involving equity investors in a limited partnership and applying state law); *In re Lake States Commodities, Inc.*, 253 B.R. 866, 869 (Bankr. N.D. Ill. 2000) (non-SIPA case involving investor in commodities positions); *In re Old Naples Sec., Inc.*, 343 B.R. 310, 317 (Bankr. M.D. Fla. 2006) (SIPA case where transfers were wholly unsupported by customer statements or antecedent debt); *In re Global Trading Invs. LLC*, No. 05-1332, 2006 WL 3040918, at *2, 6 (Bankr. D.N.J. Oct. 25, 2006) (non-SIPA case involving equity investors in a hedge fund and applying state law); *In re Churchill Mortgage Inv. Corp.*, 256 B.R. 664, 679-80 (Bankr. S.D.N.Y. 2000) (non-SIPA case acknowledging that transfers on account of antecedent debt cannot be avoided); *In re Indep. Clearing House Co.*, 77 B.R. 843, 858 (D. Utah 1987) (non-SIPA case avoiding transfers for reasons of public policy and equity).

The Trustee's particularly favored precedent, *Armstrong v. Collins*, a receivership case involving transfers from a hedge fund, is entirely inapplicable. *See* No. 01 Civ. 2437, 2010 WL 1141158, at *27-29 (S.D.N.Y. Mar. 24, 2010). The "statement receiving" customers in *Armstrong* did not contest liability for so-called "fictitious profits" and, thus, the obligation of a *broker* to its customers as reflected on *brokerage* statements was not even raised, let alone litigated and decided.

scheme presumption" similarly has its genesis in common law cases. *See, e.g.*, *In re Tedlock Cattle Co.*, 552 F.2d 1351 (9th Cir. 1977).

These concepts have no place in this case. BLMIS was not a hedge fund. The targeted transfers were not dividends paid to equity investors. On the contrary, BLMIS was a registered broker. The transfers were legally protected payments that discharged its legally enforceable debts to its customers for blue chip securities like Exxon and Walmart, not dividends on BLMIS equity interests.[23] Such payments cannot be avoided as fraudulent, and no "Ponzi scheme presumption" of fraudulent intent is relevant.

Recognizing this flaw in his analysis, the Trustee makes the misleading argument that because they bought blue chip securities and were not lenders to BLMIS, the Sterling Defendants actually are comparable to investors in hedge funds. He argues that they "received equity in exchange for their investments; they did not loan BLMIS money for a contractually determined time at a contractually determined rate of interest." (Trustee Opp. at 68 n.55.) The argument is disingenuous and utterly contrary both to SIPA itself, which expressly provides that customers are creditors, *see* 15 U.S.C. § 78fff-2(c)(1), and to state laws that provide that a broker is indebted to its customer for the securities on the statements issued by the broker, *see, e.g.*, NYUCC § 8-501.[24] The Sterling Defendants

[23] The SEC just recently, on June 15, 2011, reiterated the importance of brokerage customer statements, stating that requiring brokers to provide customers with statements "provides a key safeguard for customers by ensuring that they receive on a regular basis information concerning securities positions and assets held in their accounts. Customers can use that information to identify discrepancies and monitor the performance of their accounts." Broker-Dealer Reports, Exchange Act Release No. 34-64676, at 16; *see also id.* at 68-69 ("Like trade confirmations, account statements are important investor safeguards to monitor transactions that occur in an investor's securities account.").

[24] SIPC and the Trustee distort the commentary on the NYUCC. (Trustee Opp. at 63-64; SIPC Opp. at 21-22.) The Official Comment notes that the NYUCC "does not necessarily determine how property held by a failed intermediary will be distributed in insolvency proceedings," but it still governs "the property interest of entitlement holders in the assets held by the intermediary." NYUCC § 8-503

deposited funds in BLMIS in exchange for BLMIS' obligation to them for securities and received funds in exchange for their release of that obligation. The resulting debtor-creditor relationship is entirely different, as a matter of law, from the typical Ponzi scheme structure on which the Trustee relies.

### 2. Customers Are Creditors and SIPA's "Customer" Definition and Protections Are Not Different in a Ponzi Scheme Case

Because their claims are not supported by applicable law, the Trustee and SIPC are required to invent novel interpretations of SIPA, claiming that it modifies the avoidance provisions of the Bankruptcy Code. Thus, they argue that SIPA's "customer" and "net equity" definitions divide customers into two categories, "net winners" and "net losers"; give only "net losers" "net equity" claims; give "customer" claims only as to amounts deposited with the broker; and require that payments to "net winners" be avoided to the extent necessary to achieve equality between "net winners" and "net losers." (Trustee Opp. at 92-93; *see also* SIPC Opp. at 6 n.5.)

This analysis is completely unfounded, but in any event is irrelevant to the question of whether the payments by BLMIS discharged antecedent debt. The Trustee cannot dispute that customers have claims based on BLMIS' fraud and breach of its obligations to them. Whether these are "customer" claims or "creditor" claims, they constitute valid antecedent obligations of BLMIS, and the existence of such obligations defeats the Trustee's ability to bring *any* fraudulent conveyance claim for payments discharging such obligations.

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cmt. 1. First, SIPA is of no application during the years before a SIPA filing. Second, although the priority of distribution is governed by SIPA, the NYUCC governs the existence of antecedent debt. SIPA and the NYUCC work in tandem, not at cross purposes, so no preemption or Supremacy Clause issue is raised.

In addition, none of these concepts is found in the words of SIPA.

SIPA's "customer" definition is very broad and includes "any person who has deposited cash with the debtor for the purpose of purchasing securities." 15 U.S.C. § 78*lll*(2). The definition makes no mention of "net winners" and "net losers" and is not based upon calculation of funds deposited or withdrawn.[25] This is not surprising, as none of the federal or state securities laws requires a broker to maintain a running tally of cash deposited and cash withdrawn, starting with the first deposit. Such data is irrelevant to securities investments—the broker is required instead to record transactions in, and ownership of, securities, as one might expect. *See, e.g.*, SEC Rule 17a-3, 17 C.F.R. § 240.17a-3 (Records to Be Made by Certain Exchange Members, Brokers and Dealers).

Nor does any provision of SIPA limit a "customer" securities claim to net cash deposits. On the contrary, under the securities laws customers are owed the securities for which the broker is obligated, as set forth on the customer's statement. SIPA cannot be read to state that, as to obligations existing prior to any SIPA proceeding, the broker is retroactively liable only for some of the obligations on a brokerage statement.

### 3. The Avoidance Provisions Are Not Enlarged in the SIPA Liquidation of a Broker Engaged in a Ponzi Scheme

SIPC and the Trustee, having wrongly interpreted SIPA as mandating a unique objective in this case, also wrongly interpret SIPA to modify the avoidance powers in this case.

[25] SIPA also requires "prompt" payments to customers. *See* 15 U.S.C. § 78fff-2(b) ("[T]he trustee shall *promptly* discharge . . . all obligations of the debtor to a customer . . . ." (emphasis added)). Interpreting SIPA to require an incredibly expensive and lengthy *ex post facto* calculation of cash in/cash out before any payment is made—or for any other purpose—is inconsistent with the words and purpose of the statute.

First, because only the fraudulent conveyance power permits avoidance of transfers that occurred more than 90 days before the filing, SIPC and the Trustee are required to contend that BLMIS owed customers nothing because, otherwise, the existence of antecedent debt would preclude the use of that power. SIPC argues that BLMIS *never* owed its customers the securities on their statements, but only their "net equity," the "difference between the amounts deposited by them with the brokerage and the amounts withdrawn."[26] (SIPC Opp. at 20-25.) The Trustee goes even further, arguing that BLMIS owed its customers nothing because customers never actually paid for their securities, as both BLMIS' obligations and payments on those obligations were avoidable. Consequently, there was never any antecedent debt to be discharged. (Trustee Opp. at 61-66.)

It is startling that SIPC, under the plenary authority of the SEC, and the Trustee, a fiduciary for victimized BLMIS customers, could argue that a broker's fraud gives it a defense to its customers' claims. It is also nonsensical. The Sterling Defendants had valid claims against BLMIS under federal and state securities laws at the time the targeted transfers were made. Whether these claims would or would not have been afforded "customer" status under SIPA is irrelevant. The transfers satisfied BLMIS'

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[26] The Sterling Defendants disagree with this interpretation as well, and it is this issue that is now before the Second Circuit. *See In re Madoff*, 424 B.R. 122 (Bankr. S.D.N.Y. 2010), *appeal docketed sub nom.*, *In re Bernard L. Madoff Inv. Sec. LLC*, No. 10-2378 (2d Cir.). SIPC and the Trustee complain that the Sterling Defendants are relitigating that issue in this case. On the contrary, the question before the Second Circuit is how the customers' "net equity" claims against the SIPC Fund and the BLMIS estate are to be calculated. *See* Joint Designation of Items to Be Included in the Record and Statement of the Issue to Be Presented on Appeal, *In re Madoff*, No. 08-01789, doc. no. 2125, at 2 (Bankr. S.D.N.Y. Apr. 1, 2010). The Sterling Customers argue that the customer's *last* statement determines what the broker owes the customer and, therefore, defines the customer's net equity claim. In this case, SIPC argues, for the first time, that *all* customer statements are invalid for purposes of determining if prior payments to customers were supported by legally valid obligations. The remarkable contention that SIPA retroactively redefines the broker's debt to the customer, established long before a SIPA filing, is not before the Second Circuit.

valid obligations to the Sterling Defendants *when they were made*. *See In re TOUSA, Inc.*, 444 B.R. 613, 666 (S.D. Fla. 2011) ("[W]hether a debtor received reasonable equivalent value must be evaluated as of the date of the transaction.").

Because these transfers discharged valid debt and because the objective of this Complaint is said to be the equalization of recoveries of all customers, the transfers may be avoided, if at all, only under the *preference* provision of the Bankruptcy Code, 11 U.S.C. § 547. (Sterling Br. at 58-60.) That provision limits avoidance to transfers within 90 days of a filing. The Trustee, of course, is targeting transfers occurring over a twenty-five-year period. Therefore, SIPC and the Trustee argue, the fraudulent conveyance provisions *must* apply because "absent authority to sue under section 548 or other avoidance provisions, recovery for the benefit of customers and other creditors would be extremely limited and possibly nil if a preference could not be shown." (SIPC Opp. at 16.)

But SIPA—and the Bankruptcy Code—permit only "extremely limited and possibly nil" recovery from customers-creditors if the elements of a preference cannot be shown (and indeed, more recent legislation prevents preference avoidance as well). Thus, the Sterling Defendants do not, as the Trustee contends, dispute the Trustee's right to employ the Bankruptcy Code's fraudulent transfer provisions—the Sterling Defendants dispute his illegitimate use of those powers against customers to target legally protected withdrawals from their brokerage accounts.

Further, contrary to the contentions of SIPC and the Trustee, the Sterling Defendants do not seek to render the avoidance powers weaker in a SIPA case. Rather, the Sterling Defendants object to the Trustee's claim that he has super powers under

SIPA that are inconsistent with the Bankruptcy Code's limitations on avoidance. SIPA expressly provides that Section 548 and the other Bankruptcy Code avoidance powers apply in a SIPA case only "if and to the extent that [a] transfer is voidable or void under the provisions of title 11," 15 U.S.C. § 78fff-2(c)(3)—exactly as they do in a bankruptcy case. Therefore, SIPA does not expand Section 548 or any other avoidance power, and they may not be enlarged simply to support the Trustee's and SIPC's unfounded objectives. *See Thomas v. Whalen*, 962 F.2d 358, 363 (4th Cir. 1992) ("A federal court, whether in law or in equity, has no authority to depart from the clear command of a statute in order to effect a result that it believes to be . . . dictated by general principles of fairness."); *In re W. World Funding, Inc.*, 54 B.R. 470, 476 n.2 (D. Nev. 1985) ("The Court's equitable powers are limited by the express provisions of the [Bankruptcy] Code.").

#### 4. Intent Is Irrelevant Because the Trustee Cannot Prove That the Sterling Customers Participated in BLMIS' Fraud

Finally, the Trustee and SIPC argue that the Sterling Defendants withdrew funds from their brokerage accounts in bad faith because they should have known that BLMIS was operating a Ponzi scheme. The Sterling Defendants have demonstrated that the Trustee's factual allegations of complicity are false. In addition, because the targeted transfers discharged antecedent debt, they are not avoidable as fraudulent and considerations of "good faith" are irrelevant. *See, e.g.*, *In re Sharp Int'l Corp.*, 403 F.3d 43, 54 (2d Cir. 2005); (Sterling Br. at 64-66).

Rather, the Trustee must allege and prove that the Sterling Defendants—each one of them—were complicit. He cannot do so by claiming only that the Sterling Defendants

had "hundreds of millions of dollars worth of motive to continue investing with BLMIS" and chose to "work around the warnings about BLMIS' lack of verifiable legitimacy instead of conducting even the most cursory investigation." (Trustee Opp. at 75-76.) He must show knowing participation. (Sterling Br. at 68-70.)

The Trustee and SIPC disagree. They argue that *Sharp* stands only for the proposition that a transfer in which the recipient knew it was receiving fraudulently obtained funds may not be avoided where the transfer discharged a valid debt accrued before the fraud began. (Trustee Opp. at 66-68; SIPC Opp. at 26.) But neither *Sharp* nor *Boston Trading*, upon which *Sharp* relies, limits its analysis to a particular temporal fact pattern. On the contrary, Justice Breyer's conclusion in *Boston Trading* was based upon a sweeping review of case law, spanning many different fact patterns over several centuries:

> "[W]e have found no modern case (nor any reference in any modern case, treatise, or article to any case in the past 400 years) that has found a fraudulent conveyance [where S & K, officers of Corporation C, obtain C's money through dishonest means such as larceny or fraud and use it to pay a debt that S & K owe B, a transferee who knows of, but did not participate in, S & K's dishonesty]. That is not surprising, for the fraud or dishonesty in this example concerns not S & K's transfer to B, but *the manner in which the original debt to C arose*. 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." *Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1510 (1st Cir. 1987).

Therefore, a payment on account of antecedent debt cannot be avoided as fraudulent unless, as *Boston Trading* holds, the Sterling Defendants "participated" in BLMIS' fraud and, consequently, the antecedent debt was invalid.

The Trustee argues, in essence, that the Sterling Defendants aided and abetted Madoff's fraud through their willful blindness and failure to discover and disclose Madoff's fraud. But a brokerage customer has no duty to investigate, or to tell other customers, about a broker's fraud. Customers are protected from fraud by the law; they are not mandated to protect others. (Sterling Br. at 77-78); *cf. In re Agape Litig.*, No. 09-CV-1606, 2011 U.S. Dist. LEXIS 33587, at *65-67 (E.D.N.Y. Mar. 29, 2011) (finding that even a bank receiving an explicit report of fraud is under no obligation to disclose it, and citing, among others, *Sharp*, 403 F.3d at 53; *Rosner v. Bank of China*, No. 06-CV-13562, 2008 U.S. Dist. LEXIS 105984, at *14 (S.D.N.Y. Dec. 18, 2008), *aff'd*, 349 Fed. App'x 637 (2d Cir. 2009)); *In re Bayou Hedge Funds Inv. Litig.*, 472 F. Supp. 2d 528, 534 (S.D.N.Y. 2007) (finding law firm had no duty to disclose to investors that its client was engaged in a Ponzi scheme absent a fiduciary relationship with someone other than its client).

Because no fraudulent conveyance claim may be stated, and there is, thus, no need to demonstrate good faith or lack of bad faith, that standard is inapplicable. But the Sterling Defendants have met even that standard, whether it is objective, as set forth in the cases discussed in *Bayou* and in the moving memorandum (Sterling Br. at 75-80), or subjective, requiring demonstration of the actual honesty and integrity of the defendant, as advocated by *In re Teleservices Group, Inc.*, 444 B.R. 767, 773-74 (Bankr. W.D. Mich. 2011). Under either analysis, no fraudulent transfer claim can succeed if there was no effective action that a defendant could have taken to discover the fraud. *See In re Bayou Group, LLC*, 439 B.R. 284, 311 (S.D.N.Y. 2010); *see also* Trial Tr., *In re Bayou Group, LLC*, 09 CV 2340, 1362:17-1363:3 (S.D.N.Y. May 11, 2011) (jury instructions

providing that, if the jury finds "that a diligent investigation would not have led to discovery of insolvency or fraudulent purpose, then you must return a verdict in favor of [the] defendant") (Seshens Supp. Decl., Ex. AA).

The Trustee's opposition brief completely ignores the futility standard because he cannot satisfy it. (Sterling Br. at 75-76 (describing *Bayou*'s two-step analysis).) He never suggests what Saul Katz or any other Sterling Defendant, or for that matter any customer, could or should have done had he been suspicious. The Trustee has not alleged, nor could he ever prove, that Saul Katz somehow could have uncovered what the SEC, FINRA, and scores of professional investors did not. Nor can he deny that the most reasonable thing a customer who is suspicious of his broker could do would be to follow the SEC's direction: go to the SEC. *See* SEC, Avoiding Fraud, http://investor.gov/investing-basics/avoiding-fraud (last visited June 20, 2011). In this case, that path would have been futile.

### B. Section 546(e) of the Bankruptcy Code Requires Dismissal of the Complaint

Section 546(e) of the Bankruptcy Code precludes, by its express terms, any avoidance of a transfer—as either fraudulent or preferential—from a broker or a financial institution "in connection with a securities contract," unless it is an intentionally fraudulent transfer within two years of a filing. Thus, this provision expressly precludes any avoidance of the targeted transfers that occurred before December 11, 2006. No targeted transfer may be avoided as preferential.

The Trustee argues that Section 546(e) does not apply here because it is "incompatible with SIPA" and because "Madoff never actually traded in securities for

customers, and thus never entered into securities contracts on his investors' behalf." (Trustee Opp. at 90.) SIPC agrees that Section 546(e) cannot protect transfers in connection with "phantom" trades. (SIPC Opp. at 19.) The Trustee also contends that BLMIS was not a "broker" for purposes of Section 546(e). (Trustee Opp. at 92.)

None of these arguments can prevail. First, Section 546(e), like other federal statutes, must be given its plain meaning. *See Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) ("[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then, this first canon is also the last: 'judicial inquiry is complete.'"); *Lee v. Bankers Trust Co.*, 166 F.3d 540, 544 (2d Cir. 1999) ("It is axiomatic that the plain meaning of a statute controls its interpretation, and that judicial review must end at the statute's unambiguous terms." (internal citation omitted)); *see also, e.g.*, *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 986-87 (8th Cir. 2009) (providing that, "[b]y its terms," Section 546(e) "has a sufficiently plain and unambiguous meaning" for its language to control and prohibit avoidance of payments to shareholders in a leveraged buyout transaction).

The words of the provision are unambiguous and preclude the avoidance of transfers by a stockbroker or financial institution in connection with a securities contract, unless such transfers were made with actual intent to defraud within two years of the filing. Although the Trustee and SIPC unaccountably argue that there were no such contracts because BLMIS executed no trades for customers, they are wrong—many legally enforceable contracts were executed between BLMIS and its customers for the

purchase of securities.[27] BLMIS breached those contracts, but not by making the payments it was obligated to make. The breach was the failure to buy securities, but that breach does not permit the *broker* to recover its payments to customers.

Second, as already discussed, Section 546(e) is a limitation on the Bankruptcy Code avoidance powers. Those powers apply in a SIPA case only "if and to the extent that [a] transfer is voidable or void under the provisions of title 11." 15 U.S.C. § 78fff-2(c)(3). Section 546(e) plainly limits the voidability of transfers under Title 11 and, therefore, on its face applies in a SIPA proceeding. That Section 546(e) restricts the Trustee's illegitimate exercise in this case is not a basis for concluding that is does not apply. Nor, contrary to the Trustee's protests, does Section 546(e) except from its scope all transfers that were part of a Ponzi scheme. (Trustee Opp. at 90-91.) On the contrary, Section 546(e) expressly excepts from its scope only intentionally fraudulent transfers within two years of a filing. Congress did not overlook the possibility of fraud—

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[27] The Trustee's assertion that such contracts must be for the purchase or sale of a "particular" security is wrong. *See* 11 U.S.C § 741(7)(A)(i), (vii), (x) (defining "securities contract" as "a contract for the purchase, sale, or loan of a security . . . or option on any of the foregoing," "any other agreement or transaction that is similar to an agreement or transaction referred to in this subparagraph," or "a master agreement that provides for an agreement or transaction referred to in clause (i) [or] (vii)").

The claim that, because no securities were traded, the market protection provided by Section 546(e) is irrelevant, is equally wrong. As SEC Chairman Mary Schapiro recently noted:

> "The fact is that when investors hand their assets over to a broker-dealer, they trust that their broker-dealer will hold and invest the assets as directed. But when a broker-dealer violates that trust and misuses the assets, *that broker not only harms the investor but also erodes confidence broadly in the financial system.*" Mary Schapiro, Chairman of the SEC, Opening Statement at SEC Open Meeting: Proposals to Amend Rule 17a-5 (June 15, 2011), *available at* http://www.sec.gov/news/speech/2011/spch061511mls.htm (last visited June 20, 2011) (emphasis added).

Congress addressed the treatment of fraudulent transfers in the plain language of Section 546(e).[28]

Third, as already noted, the Courts of this District have found that BLMIS' failure to purchase securities does not result in the loss of Rule 10b-5 protection. (Sterling Br. at 83-84 (citing *In re J.P. Jeanneret Assocs., Inc.*, 09 Civ. 3907, 2011 U.S. Dist. LEXIS 9630, at *52-59 (S.D.N.Y. Jan. 31, 2011) (finding "in connection with" requirement of securities fraud claim satisfied even though Madoff failed to purchase or sell securities and citing numerous Second Circuit courts holding the same)).) Nor should the apparent failure to trade for customers limit the protection granted by Section 546(e). *See In re Enron Creditors Recovery Corp.*, 422 B.R. 423, 437-38 (S.D.N.Y. 2009) (finding no purchase or sale of a security need have taken place for the 546(e) "settlement payment" safe harbor to apply).

Finally, BLMIS is the subject of a SIPA proceeding. Only a registered broker qualifies as a candidate for a SIPA proceeding. *See* 15 U.S.C. §§ 78ccc(a)(2)(A)(ii) (stating membership criteria for SIPC as a "person[] whose *business as a broker or dealer* consists exclusively of [certain activities]"), 78eee(a)(3)(A). If BLMIS was a broker under applicable law when it engaged in the targeted transfers and when the SIPA proceeding was filed, BLMIS must be considered a broker under Section 546(e).

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[28] Further, the cases cited by the Trustee are irrelevant because they focus on the "settlement payment," and not the "securities contract," limitation of Section 546(e), *see In re Grafton Partners, L.P.*, 321 B.R. 527, 535-39 (B.A.P. 9th Cir. 2005); *In re Adler, Coleman Clearing Corp.*, 263 B.R. 406, 478-81 (S.D.N.Y. 2001); *In re Enron Corp.*, No. 03-92677, 2008 WL 281972, at *2-5 (S.D.N.Y. Jan. 25, 2008), or because they found the debtor had no customers, *see Wider v. Wootton*, 907 F.2d 570, 571-72 (5th Cir. 1990).

## IV. THE TRUSTEE'S IMPUTATION THEORIES CANNOT BE SUSTAINED

As to most of the nearly 100 Sterling Defendants, the Trustee alleges no fact other than that the Defendant received targeted transfers. Therefore, there is no basis for claiming that each was complicit and no basis for any fraudulent conveyance claim against them. But the Trustee has sued everyone, including the New York Mets and minor grandchildren, contending that a hodge podge of imputation theories causes *all* of them to be liable as participants in Madoff's fraud. (*See* Compl. ¶¶ 1080-1101.)

To support such an extreme position, the Trustee would have to prove:

1. Knowledge of and participation in the fraud on the part of one or more Sterling Partner;

2. Imputation of that knowledge and participation to all Sterling Partners; and

3. Imputation of the knowledge and participation of the first Partner to *all* of the various chains of family relationship (including ones not his own) and corporate ownership, or imputation of the knowledge and participation of *all* Partners a second time through these same chains of family relationship and corporate ownership so that all relatives and entities are charged with that knowledge.

The Trustee has failed to allege or support any of this.

First, the Complaint claims that Saul Katz, while he was overseeing the Sterling Partners' investment in Sterling Stamos, was warned of the possibility of some sort of wrongdoing by Madoff. The Trustee claims that all of the Partners are liable for Saul Katz's purported "willful blindness" to these warnings.

This first step is fundamentally flawed. Knowledge may be imputed among partners under some circumstances; notice, or constructive knowledge, cannot. (Sterling Br. at 89-90.) Aware of this fundamental deficiency in his analysis, the Trustee suggests that each Partner was on notice of something, and if he is allowed to put all of the random pieces of information together, his chances of imputing notice of the random information improve. (Trustee Opp. at 105 n.70.) He has no factual support for this theory, which is based in part on allegations the Trustee has abandoned (*see, e.g.*, Compl. ¶¶ 915, 919), or allegations that were not even alleged to have been communicated to any Sterling Partner (*see, e.g.*, *id.* ¶¶ 922-924). Further, although he claims that "some or all of the indicia of Madoff's fraud were discussed between or among the Sterling Partners" (*id.* (citing allegations in the Complaint made almost entirely "upon information and belief")), the undisputed evidence demonstrates that this was not the case. (*See supra* Section I; Sterling Br. at 20 n.7.)

Consequently, the Trustee cannot equate the ten individual Sterling Partners with a single investment professional so as to force this case into the parameters of *Picard v. Chais*, 445 B.R. 206 (Bankr. S.D.N.Y. 2011). There, the Trustee alleged that Mr. Chais was the mastermind behind the investments in all of his and his family's BLMIS accounts. *See id.* at *5-7; (Trustee Opp. at 102-105). Here, the evidence is completely to the contrary—investments in the many accounts were not made by any single person or group.[29] (Sterling Br. at 51, 88 n.40.) Indeed, if that had been the case, there would have

[29] The Trustee fails to refute the testimony of the Sterling Partners that each Partner made his own BLMIS investment decisions by, for example, citing irrelevant testimony about how the interest rate is set for funds loaned by Sterling's internal bank. (Rule 56.1 Response ¶¶ 21-22.) And the Trustee's focus on the "double up" accounts only serves to undermine his theory. (*Id.*) He selectively cites from the

been no need for the creation of so many accounts, each permitting a particular individual, group of individuals, or entity to make an independent decision about depositing or withdrawing funds from BLMIS.

Nor is his theory saved by either the incorrect claim that Arthur Friedman controlled the accounts or that all of the Partners did so by virtue of group briefings on BLMIS' performance. (Trustee Opp. at 94, 96.) The testimony is clear that Mr. Friedman made no investment decisions for other Sterling Defendants.[30] And because every account was a split-strike account, the returns were the same for each. Briefing the Partners together was sensible, but it does not conflict with the evidence that each Partner, or group, or entity made an individual decision about when and how much to deposit with or withdraw from BLMIS.

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testimony of Mark Peskin, which, when properly cited, confirms that each individual Partner decided whether or not to invest in a double up account. (Peskin Tr. 51:19-52:13 ("Q. So who determined when there was an excess of funds? A. The individual partners knew their own personal accounts. When there was—people wouldn't realize there were excesses. Arthur [Friedman] would be in charge to call up the capital accounts. He would know, and he would say, hey, everybody has a little bit more money than expected. What do you want to do with it? . . . [D]ecisions are made by the partners. So you want to come in, great. You don't want to come in, that's okay, also. And they [the Partners] would form a pool of money to be doubled up."); 55:23-56:3 ("Q. So Mr. Friedman would notify the partners and executives that they had excess funds, and those funds could or could not have been used to invest in the Sterling [double up accounts]? A. Correct. It was up to the *individual* partner to make that decision.") (emphasis added) (Seshens Supp. Decl., Ex. BB)); *see also* Friedman Tr. 487:19-488:6 (describing the decision to invest in a double up account as "voluntary" for each individual partner) (Seshens Supp. Decl., Ex. U).)

[30] Mr. Friedman did nothing more than provide administrative services in connection with their accounts, such as passing along deposits and withdrawals or providing necessary documentation. (Friedman Tr. 71:22-72:22 ("[W]henever anybody wanted to invest money in Madoff, they would send me the check . . ., and I would forward it on to Madoff. And vice versa, if they wanted to withdraw money, they would notify me, either by email or letter or telephone what they wanted to withdraw, from what account, when, if there was an urgency, and I would, again, transmit that information to Madoff."); 121:10-22 ("I never made a determination on my own to open an account or to have somebody else open an account."); 122:14-20 ("I wasn't involved, that I can recollect, in making any kind of determination [to open a new BLMIS account]."); 249:6-12 ("Q. You set up many of the accounts? A. What does it mean, 'set up?' Q. You did the paperwork to open the accounts with Madoff? A. I had the paperwork prepared and [got] necessary signatures and submitted them to the Madoff firm, yes.") (Seshens Supp. Decl., Ex. U).)

Therefore, the first block in the Trustee's edifice cannot bear the weight of his grand theory. The next steps are completely invalid. Notice, or constructive knowledge, having been imputed once, cannot then be imputed again and again, to spouses, children, grandchildren, charitable foundations, and separate corporate entities. Not a single case, Restatement, or statute supports the imposition of huge liabilities on the basis of imputing constructive knowledge multiple times. (*See infra* at 62-65.)

The Trustee's framework depends upon some claim of agency. But when Mr. Katz was acting with regard to the *Sterling Stamos* investment, he was not acting for any Sterling Partner—or for anyone else—with regard to their *BLMIS* investments. An agency relationship for one purpose does not equal an agency relationship for all purposes. The Trustee completely ignores the scope-of-agency restrictions placed on imputing an agent's knowledge to its principal, even though the very case law he cites supports this uncontroversial proposition. *See Bennett v. Buchan*, 76 N.Y. 386, 390-91 (1879) (agent must acquire knowledge "while engaged in the business of his principal"); *Hilton v. Federated Brokerage Group, Inc.*, 213 N.Y.S.2d 171, 176 (N.Y. Sup. Ct. 1961) (agent must have acquired knowledge while "engaged in his principal's business"); *Raines v. Moran*, 57 N.Y.S.2d 800, 807 (N.Y. Sup. Ct. 1945) (agent must receive notice while "in the business or employment which he is carrying on for his principal").

Absent the ability to establish an agency relationship, sustaining a demand for one billion dollars—including claims against individuals as to whom no allegations are made—based on claims of imputed *knowledge* is impossible. And here, the claims are based on allegations of imputed *constructive notice*, which cannot be imputed at all, let

alone through multiple human and corporate layers.[31] The cases cited to support the Trustee's theory are bizarrely inapposite and cannot support the claims in the Complaint. *See, e.g.*, *United States v. Josleyn*, 206 F.3d 144, 159-60 (1st Cir. 2000) (deeming outside counsel an agent of corporation in connection with motion for new criminal trial based, in part, upon post-trial evidence that counsel had ordered damaging documents shredded); *Baker v. Latham Sparrowbush Assocs.*, 72 F.3d 246, 255-56 (2d Cir. 1995) (finding service of process on organizer, president, and controlling officer of wholly owned corporation sufficient to constitute notice of proceeding to the corporation); *Center v. Hampton Affiliates, Inc.*, 66 N.Y.2d 782, 784 (1985) (finding triable issue of fact as to whether lawyer's alleged knowledge was imputable to corporation in connection with whether corporation received stock without notice of plaintiff's claimed right to it); *5015 Art Fin. Partners, LLC v. Christie's, Inc.*, 870 N.Y.S.2d 331, 333 (1st Dep't 2009) (finding that a principal-agent relationship *did not exist* in context of art fraud scheme where purported agent was acting solely for his own benefit); *546-552 W. 146th St. LLC v. Arfa*, 863 N.Y.S.2d 412, 414-15 (1st Dep't 2008) (dismissing claims of LLCs against LLCs' principals in connection with series of real estate transactions because principals were sole actors and, thus, their conduct was imputable to plaintiffs); *Maurillo v. Park*

[31] The Restatement (Third) of Agency (2006) does not alter this conclusion. (Trustee Opp. at 106-107.) The Third Restatement provision upon which the Trustee relies speaks of "notice of fact," not notice of constructive "willful blindness"—a state of mind reflecting actual knowledge and intent—based on constructive notice of the supposed underlying facts. Further, the Restatement provides that imputed knowledge has different legal consequences depending upon the liability sought to be imposed, who is seeking to impose it, and the duties owed, such as liability in tort or in the context of a transaction with a third party. *See* Restatement (Third) of Agency § 5.03 cmt. d. Here, the Trustee seeks to impose a billion dollar liability upon each Sterling Defendant based upon participation in a fraud by imputing a "should have known" standard multiple times. Neither the Third Restatement nor any of the cases relied upon by the Trustee supports such a theory.

*Slope U-Haul*, 606 N.Y.S.2d 243, 246-47 (2d Dep't 1993) (allowing indemnification claim to go forward against car driver's father where son was driving at the father's request, thereby giving rise to an agency relationship, even though intrafamilial activity typically does not give rise to one).[32]

The remaining theories advanced by the Trustee too are wholly inapplicable. The Trustee effectively concedes, as he must, that no veil piercing theory is available, (Trustee Opp. at 98 n.65), because he has not alleged, nor can he prove, that the corporate form of the Entity or Katz/Wilpon Trust Defendants was used in any way to commit a fraud or similarly dishonest act—particularly on BLMIS. (Sterling Br. at 90-91.)

The Trustee's "*de facto*" ownership theory is equally far-fetched. Relying on various allegations that appear nowhere in his Complaint, the Trustee claims that the Sterling Partners' *post*-December 11, 2008 debt restructuring in the wake of the Madoff fraud evidences their *pre*-December 11, 2008 domination and control of the Entity and Katz/Wilpon Defendants in connection with their BLMIS-related investments. (Trustee Opp. at 98-100.) One is not probative of the other. And, as the Trustee well knows from reams of paper produced to him, the debt restructuring meticulously addressed all applicable corporate formalities. Each participant independently agreed to the

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[32] The Trustee's reliance on cases involving actual agent misconduct and possible imputation of the resultant legal consequences are even more irrelevant to his unfounded imputation theories. *See, e.g.*, *Fid. & Guar. Ins. Underwriters, Inc. v. Jasam Realty Corp.*, 540 F.3d 133, 139-40 (2d Cir. 2008) (imputing insurance broker's *actual knowledge* to insurance underwriter because knowledge acquired within scope of agency relationship); *Sims v. Bergamo*, 3 N.Y.2d 531, 534-35 (1957) (providing that bar proprietor could be held vicariously liable for bartender's alleged assault on patron if conduct committed within scope of bartender's employment); *Murray v. Watervliet City Sch. Dist.,* 515 N.Y.S.2d 150, 151-52 (3d Dep't 1987) (finding that school district may be vicariously liable for teacher's slander if within the scope of her employment); *Hatton v. Quad Realty Corp.*, 473 N.Y.S.2d 827, 829 (2d Dep't 1984) (finding mortgagee and its assignees responsible for tortious acts of agent where conduct was foreseeable); *Lippes v. Atl. Bank*, 419 N.Y.S.2d 505, 508-09 (1st Dep't 1979) (affirming jury charge permitting bank to be held liable where bank officer processed forged promissory notes).

restructuring—not because each was under the control of a central authority or because some central authority ran roughshod over the rights of the others, but because it was in the interest of each participant to avoid a loan default.

His legal authority is, again, entirely irrelevant and inadequate to support a billion dollar claim based on imputed knowledge of a fraud. *See, e.g.*, *Freeman v. Complex Computing Co.*, 119 F.3d 1044, 1051-52 (2d Cir. 1997) (finding *de facto* ownership where defendant functioned as sole shareholder, agreed to personally indemnify the entity, and treated assets as his own); *FTC v. Data Med. Capital, Inc.*, No. SA CV 99-1266, 2010 U.S. Dist. LEXIS 3344, at *52-54 (C.D. Cal. Jan. 15, 2010) (analyzing under *California law* whether *actual knowledge* of *de facto* CEO of private corporation was imputable to corporation); *SEC v. Ballesteros Franco*, 253 F. Supp. 2d 720, 729-30 (S.D.N.Y. 2003) (imputing defendant's knowledge to trusts where defendant was their beneficiary and used them to effectuate his fraud); *Shamis v. Ambassador Factors Corp.*, 34 F. Supp. 2d 879, 889 (S.D.N.Y. 1999) (finding issue of fact as to equitable ownership where plaintiff alleged that defendant treated entity as "his own piggy bank" amid evidence that defendant's American Express bills reflected personal purchases paid for by entity); *Banco de Desarrollo Agropecuario v. Gibbs*, 709 F. Supp. 1302, 1306-07 (S.D.N.Y. 1989) (deeming allegations regarding financial advisor that also controlled the company's finances sufficient to render advisor a control person for purposes of breach of fiduciary duty claim as part of Bahamian liquidation proceeding); *In re Grumman Olson Indus.*, 329 B.R. 411, 427-28 (Bankr. S.D.N.Y. 2005) (analyzing whether outsider was "control person" of debtor and, therefore, became an "insider" who used his position to gain favorable treatment with debtor).

## V. THE TRUSTEE'S REMAINING ARGUMENTS HAVE NO MERIT

The Sterling Defendants demonstrated in their moving papers that the Trustee's claims for disallowing the Sterling Defendants' SIPC claims or otherwise equitably subordinating them are ill-founded. (Sterling Br. at 91-93.) The Trustee's responses simply demonstrate the circularity of his reasoning.

The Trustee reasserts that the Sterling Defendants' SIPC claims should be disallowed under Section 502(d) of the Bankruptcy Code because they have received avoidable transfers. (Trustee Opp. at 111-112.) But as demonstrated repeatedly, the targeted transfers cannot be avoided. Moreover, the claims process in the BLMIS case is governed by an order that is independent of this adversary case. *See* Order Approving Form and Manner of Publication and Mailing of Notices, Specifying Procedures for Filing, Determination, and Adjudication of Claims; and Providing Other Relief, *In re Madoff*, No. 08-01789, doc. no. 12, at 6 (Bankr. S.D.N.Y. Dec. 23, 2008).

The Trustee also attempts to resuscitate his claim for equitable subordination under Section 510(c). (Trustee Opp. at 113-117.) But the manner in which he does so is internally inconsistent. Recognizing that equitable subordination of a claim requires that the claimant be shown to have acted inequitably, the Trustee asserts that this requirement was satisfied when the Sterling Defendants "invested tens of millions of dollars in borrowed funds into BLMIS," which "provided Madoff with even more additional capital with which to further his fraud." (*Id.* at 115.) If providing BLMIS with capital is inequitable conduct, then *every* BLMIS customer has acted inequitably, and there is no claim to which any Sterling Defendant's claim could be subordinated. And the law is

clear that acting in a normal commercial manner does not result in equitable subordination. *See, e.g.*, *In re Agape Litig.*, 2011 U.S. Dist. LEXIS 33587, at *65-67.

The Trustee pairs this argument with the false assertion that the Sterling Defendants "steered hundreds of innocent investors to BLMIS." (Trustee Opp. at 115.) Having failed to prove that the Sterling Defendants were aware of, let alone complicit in, Madoff's fraud, such actions—even if true—could not plausibly be characterized as "contrary to equity and good conscience," *In re Verestar, Inc.*, 343 B.R. 444, 461 (Bankr. S.D.N.Y. 2006), or as "unconscionable, unjust, unfair, close or double dealing or foul conduct," *In re Adelphia Commc'ns Corp.*, 365 B.R. 24, 68 (Bankr. S.D.N.Y. 2007). The assertion, however, is not true: the Sterling Defendants did not steer new investors to BLMIS. (Sterling Br. at 52-53.)

Nor has the Trustee succeeded in showing the other essential element of equitable subordination. The Sterling Defendants *could not* have harmed the creditor body by withdrawing funds from BLMIS—as members of the creditor body themselves, releasing BLMIS from obligations it owed them with every transfer, the class of creditors as a whole was no worse off as a result of any given transfer.

# CONCLUSION

For the reasons set forth above and in their moving memorandum of law, the Sterling Defendants respectfully request that the Court dismiss the Complaint in its entirety under Bankruptcy Rule 7012(b)(6) or, in the alternative, enter summary judgment for the Sterling Defendants under Bankruptcy Rules 7012(d) and 7056.

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