Irving H. Picard v. Saul B. Katz et al Doc. 47

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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

TRUSTEE'S MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DIRECT ENTRY OF FINAL JUDGMENT UNDER FEDERAL RULE OF CIVIL PROCEDURE 54(b) AND FOR CERTIFICATION UNDER 28 U.S.C. § 1292(b)

BAKER & HOSTETLER LLP
45 Rockefeller Plaza
New York, New York 10111
Telephone: (212) 589-4200
Facsimile: (212) 589-4201

Attorneys for Irving H. Picard, Trustee for the Substantively Consolidated SIPA Liquidation of Bernard L. Madoff Investment Securities LLC and Bernard L. Madoff

Dockets.Justia.com

TABLE OF CONTENTS

Page

Preliminary Statement ... 1

Statement of Facts ... 3

A. The Amended Complaint, Motion to Dismiss & Order ... 3

B. The Instant Motion ... 5

Argument ... 6

I. The Court should direct entry of final judgment under Rule 54(b) as to Counts Two through Ten of the Amended Complaint ... 6

A. The Court finally determined nine counts of an eleven-count Amended Complaint on grounds independent of the remaining claims. ... 6

B. No just reason for delay exists in entering final judgment and injustice would result if the Court does not do so. ... 7

II. Alternatively, certification for interlocutory review under § 1292(b) is warranted. ... 9

A. The disputed rulings involve controlling questions of law that will materially affect the outcome of the litigation. ... 10

B. The Court's Order presents controlling issues of law as to which substantial grounds for difference of opinion exist ... 10

1. The Court's conclusion that § 546(e) applies to transfers made in furtherance of Madoff's Ponzi scheme conflicts with Second Circuit and other authority. ... 11

2. The Court's application of § 546(e) to bar all recoveries from subsequent transferees is an issue of first impression. ... 16

3. This Court's holding that § 502(d) is overridden by SIPA § 78fff-2(c)(3) is a matter of first impression in this Circuit. ... 17

C. An immediate appeal from the Court's Order is warranted given its unusual significance to more than 900 other actions. ... 20

III. Interlocutory appeal is warranted to resolve the conflict arising from this Court's ruling that imposes a heightened subjective standard of "willful blindness" to Defendants' good faith defense. ... 21

Conclusion ... 24

TABLE OF AUTHORITIES

Page(s)

CASES

Advanced Magnetics, Inc. v. Bayfront Partners, Inc.,
106 F.3d 11 (2d Cir. 1997)....................8

In re Air Crash at Belle Harbor, N.Y. on Nov. 12, 2001,
490 F.3d 99 (2d Cir. 2007)....................6

Barron Partners LP v. Lab123, Inc.,
No. 07 Civ. 11135, 2008 WL 2902187 (S.D.N.Y. July 25, 2008) 23

In re Bernard L. Madoff Inv. Sec.,
--- F.3d ---, 2011 WL 3568936 (2d Cir. Aug. 16, 2011) .... *passim*

In re Bernard L. Madoff Inv. Sec.,
424 B.R. 122 (Bankr. S.D.N.Y. 2010) 2

Bilello v. JPMorgan Chase Retirement Plan,
603 F. Supp. 2d 590 (S.D.N.Y. 2009)....................10

Brown v. Bullock,
294 F.2d 415 (2d Cir. 1961)....................20

Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, LLC (*In re Bayou Group LLC*),
439 B.R. 284 (S.D.N.Y. 2010)....................22, 24

Consol. Edison, Inc. v. Northeast Util.,
318 F. Supp. 2d 181 (S.D.N.Y. 2004)....................20, 24

Consub Delaware LLC. v. Schahin Engenharia Limitada,
476 F. Supp. 2d 305 (S.D.N.Y. 2007)....................11

In re Contemporary Indus. Corp.,
312 B.R. 898 (D. Neb. 2004) 10

Crigger v. Fahnestock & Co. Inc.,
443 F.3d 230 (2d Cir. 2006)....................23

Cullen v. Margiotta,
811 F.2d 698 (2d Cir. 1987)....................6, 7

Curtiss-Wright Corp. v. Gen. Elec. Co.,
446 U.S. 1 (1980)....................6, 7

Page(s)

Dodds v. Cigna Sec., Inc.,
12 F.3d 346 (2d Cir. 1993)....23

Enron Corp. v. JPMorgan Sec., Inc. (*In re Enron Corp.*),
No. M-47, 2008 WL 281972, at *5 (S.D.N.Y. Jan. 25, 2008)....14

In re Enron Creditors Recovery Corp.,
2009 WL 3349471 (S.D.N.Y. Oct. 16, 2009)....9, 20

In re Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.,
--- F.3d ---, 2011 WL 2536101 (2d Cir. June 28, 2011)....12, 15

In re Fosamax Prod. Liab. Litig.,
No. 06 MD 01789, 2011 WL 2566074 (S.D.N.Y. June 29, 2011)....21

Ginett v. Computer Task Group,
962 F.2d 1085 (2d Cir. 1992)....7, 9

Gowan v. The Patriot Grp. LLC (*In re Dreier*),
452 B.R. 391 (Bankr. S.D.N.Y. 2011)....24

Hersch v. Gersten (*In re Centennial Textiles, Inc.*),
220 B.R. 177 (Bankr. S.D.N.Y. 1998)....9

Hill v. Spencer S&L Ass'n (*In re Bevill, Bresler & Schulman, Inc.*),
94 B.R. 817 (D.N.J. 1989)....19

Jackson v. Mishkin (*In re Adler, Coleman Clearing Corp.*),
263 B.R. 406 (S.D.N.Y. 2001)....14

Jobin v. McKay (*In re M&L Bus. Mach. Co., Inc.*),
84 F.3d 1330 (10th Cir. 1996)....22

Johnson v. Neilson (*In re Slatkin*),
525 F.3d 805 (9th Cir. 2008)....14

Klinghoffer v. S.N.C. Achille Lauro,
921 F.2d 21 (2d Cir. 1990)....10, 17

Kramer v. Lockwood Pension Services, Inc.,
653 F. Supp. 2d 354 (S.D.N.Y. 2009)....20

In re Lloyd's Am. Trust Funds Litig.,
No. 96 Civ. 01262, 1997 WL 458739 (S.D.N.Y. Aug. 12, 1997)....11

TABLE OF AUTHORITIES
(continued)

Page(s)

In re Manhattan Inv. Fund Ltd.,
397 B.R. 1 (S.D.N.Y. 2007)....................22

In re Manville Forest Prod. Corp.,
31 B.R. 991 (S.D.N.Y. 1983)....................20

Matter of Bevill, Bresler & Schulman, Inc.,
83 B.R. 880 (D.N.J. 1988)....................19

In re Methyl Tertiary Butyl Ether Prod. Liab. Litig.,
No. 04 Civ. 03417, 2010 WL 1328249 (S.D.N.Y. Apr. 5, 2010)....................9

In re Mid. Atl. Fund, Inc.,
60 B.R. 604 (Bankr. S.D.N.Y. 1986)....................19

Mishkin v. Ensminger (In re Adler Coleman Clearing Corp.),
247 B.R. 51 (Bankr. S.D.N.Y. 1999)....................14, 15

Picard v. Katz (*In re Bernard L. Madoff Inv. Sec. LLC*),
No. 11 Civ. 03605, 2011 WL 4448638 (S.D.N.Y. Sept. 27, 2011).................... *passim*

Picard v. Merkin (*In re Bernard L. Madoff Inv. Sec. LLC*),
440 B.R. 243 (Bankr. S.D.N.Y. 2010)....................12, 13, 14, 15

Picard v. Merkin (*In re Bernard L. Madoff Inv. Sec. LLC*),
No. 00 MC 00012, 2011 WL 3897970 (S.D.N.Y. Aug. 31, 2011)....................10, 13, 22, 24

Picard v. Peter B. Madoff (In re Bernard L. Madoff Inv. Sec. LLC),
--- F.3d ---, 2011 WL 4434632 (Bankr. S.D.N.Y. Sept. 22, 2011).................... *passim*

Romea v. Heiberger & Assoc.,
988 F. Supp. 715 (S.D.N.Y. 1998)....................20

Ross v. Thomas,
09 Civ. 05631, 2010 WL 3952903 (S.D.N.Y. Oct. 7, 2010)....................7

Sears, Roebuck & Co. v. Mackey,
351 U.S. 427 (1956)....................7

Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec., LLC,
No. M-47, 2010 WL 185102 (S.D.N.Y. Jan. 11, 2010)....................22

Smith v. Local 819 I.B.T. Pension Plan,
291 F.3d 236 (2d Cir. 2002)....................7

TABLE OF AUTHORITIES
(continued)

Page(s)

Trugman-Nash, Inc. v. N.Z. Dairy Bd.,
954 F. Supp. 2d 733 (S.D.N.Y. 1997)..8

United States v. Rodriguez,
983 F.2d 455 (2d Cir. 1993)..24

Wider v. Wootton,
907 F.2d 570 (5th Cir. 1990) 14

In re WorldCom, Inc.,
No. M-47, 2003 WL 21498904 (S.D.N.Y. June 30, 2003)..22

In re WorldCom, Inc. Sec. Litig.,
No. 02 Civ. 03288, 2003 WL 22953644 (S.D.N.Y. Dec. 16, 2003)................................19

STATUTES & RULES

11 U.S.C. § 101 *et seq*..3

11 U.S.C. § 502(d) .... *passim*

11 U.S.C. § 546..10, 16

11 U.S.C. § 546(e) .... *passim*

11 U.S.C. § 548..10, 16

11 U.S.C. § 548(a)(1)(A) 5, 16, 17

11 U.S.C. § 548(c) 4, 5, 21, 22

11 U.S.C. § 550..4, 5, 16

11 U.S.C. § 550(a) 16, 17

15 U.S.C. § 78aaa *et seq*. 1

15 U.S.C. § 78fff-2(c)(3) .... *passim*

28 U.S.C. § 1291..6

28 U.S.C. § 1292(b) .... *passim*

N.Y. Debt. & Cred. Law §§ 270 *et seq.*..3, 4, 8, 24

Fed. R. Civ. P. 12(b)(6)..3

Page(s)

Fed. R. Civ. P. 54(b) .... *passim*

OTHER AUTHORITIES

6 *Collier on Bankruptcy* (16th ed. 2011) 18, 19

Irving H. Picard (the "Trustee"), trustee for the substantively consolidated liquidation of the business of Bernard L. Madoff Investment Securities LLC ("BLMIS") and Bernard L. Madoff ("Madoff"), under the Securities Investor Protection Act ("SIPA"), 15 U.S.C. § 78aaa *et seq*., by and through his undersigned counsel, respectfully submits this memorandum of law in support of his motion ("Motion") requesting the Court to direct entry of final judgment under Federal Rule of Civil Procedure 54(b) ("54(b)") on Counts Two through Ten of the Amended Complaint and to certify to the United States Court of Appeals for the Second Circuit under 28 U.S.C. § 1292(b) ("1292(b)") an interlocutory appeal of the Court's rulings concerning "willful blindness" with respect to the Trustee's remaining claims, set forth in its opinion and order of September 27, 2011 (the "Order") partially granting the Sterling Defendants' (the "Defendants") Motion to Dismiss the Amended Complaint, or in the Alternative, for Summary Judgment (the "Motion to Dismiss"); or, alternatively, to certify an interlocutory appeal under 28 U.S.C. § 1292(b) of the Order, both as to the bases for the Court's dismissal of Counts Two through Ten, as well as on its "willful blindness" ruling on the remaining claims.

Preliminary Statement

Nothing makes plain the relationship between the Second Circuit's "net equity" decision and the Trustee's avoidance powers more than the Court's Order here. Deeming it "absurd" to "give legal effect to Madoff's machinations," the Second Circuit held that it would have been "legal error" for the Trustee to discharge claims for securities under SIPA "upon the false premise that customers' securities positions are what the account statements purport them to be." *In re Bernard L. Madoff Inv. Sec.*, --- F.3d ---, 2011 WL 3568936, at *4, *11 (2d Cir. Aug. 16, 2011). Yet under this Court's Order, those machinations are given legal effect for the purposes of invoking the "safe harbor" provision of the Bankruptcy Code relating to securities transactions. This ruling arbitrarily provides one class of customers—those with avoidance

liability—the benefit of the fictitious trades that all customers were previously denied. In direct contravention of the Circuit's ruling, this result places "some claims unfairly ahead of others." *Id*. at *12 n.10.

The Circuit ruled that the "whim of the defrauder" should not control the process of unwinding the fraud. *Id.* at *11. Instead, the Trustee's task is to equalize the harm to all defrauded investors of BLMIS by putting the "greatest number of investors closest to their positions prior to Madoff's scheme in an effort to make them whole." *In re Bernard L. Madoff Inv. Sec.*, 424 B.R. 122, 142 (Bankr. S.D.N.Y. 2010). His duties have two interlocking components: (1) recovering customer property through avoidance and other actions; and (2) distributing customer property.

Under the Second Circuit's decision, the relative position of each BLMIS customer account must be calculated based on "unmanipulated withdrawals and deposits" from its opening date to December 2008. *In re Bernard L. Madoff Inv. Sec.*, 2011 WL 3568936, at *8. If an account has a positive cash balance, that accountholder is owed money from the estate. If an account has a negative cash balance, the accountholder owes money to the estate. Both the recovery and distribution of customer property in this case are centered on the principle that the Trustee cannot credit "impossible transactions." If he did, then "those who had already withdrawn cash deriving from imaginary profits in excess of their initial investment would derive additional benefit at the expense of those customers who had not withdrawn funds before the fraud was exposed." *Id.*

In order to put all customers on equal footing, the Circuit ruled that no customer was entitled to the benefit of those impossible transactions. Yet, this Court credits the fraudulent transactions—only for customers subject to avoidance—by applying the § 546(e) safe harbor.

This ruling results in an unequal application of law because the Second Circuit precluded any corresponding credit for those same transactions to customers owed money by the estate. The Order requires a procedure wholly irreconcilable with the standard espoused by the Second Circuit and questions the very basis on which the Trustee has unwound the fraud.

This Court's ruling, therefore, implicates far more than the claims against Defendants or similarly-situated net winners. It touches upon the interests of thousands of other creditors of BLMIS and allows net winners to avoid liability to the estate. Net losers, of course, bear the cost of that decision. As applied to this case alone or applied to any of the other more than 900 avoidance actions currently pending, the Court's Order upsets the *pro rata* scheme mandated by the Bankruptcy Code and SIPA, and derails the fair allocation of available resources to victims as mandated by the Second Circuit. On this issue alone, the Court should permit appellate review of its Order now. But as discussed more fully herein, immediate appellate review is appropriate for a host of reasons, not the least of which is that it will clarify the state of the law prior to commencement of hundreds of trials on claims that mirror those asserted against Defendants here.

Statement of Facts

A. The Amended Complaint, Motion to Dismiss & Order

The Trustee's Amended Complaint asserted fraudulent conveyance claims against Defendants under the Bankruptcy Code (the "Code"), 11 U.S.C. § 101 *et seq*., analogous provisions of McKinney's New York Debtor and Creditor Law ("NYDCL"), §§ 270 *et seq.*, and SIPA. On September 27, 2011, the Court granted Defendants' Motion to Dismiss the Amended Complaint under Federal Rule of Civil Procedure 12(b)(6) with respect to Counts Two through Ten. It denied the Motion to Dismiss with respect to Counts One and Eleven. The Court's key holdings can be summarized as follows.

First, the Court dismissed Counts Two through Nine on the ground that the "safe harbor" affirmative defense set forth in Bankruptcy Code § 546(e) is a bar—at the pleading stage—to those claims. Accordingly, the Court dismissed the Trustee's claims based on constructive fraud under the Bankruptcy Code, actual and constructive fraud under the NYDCL, and for recovery of subsequent transfers pursuant to § 550 of the Code, reducing the Trustee's claims against Defendants from approximately $1 billion to less than $400 million.

In connection with the Trustee's fraudulent conveyance claims, this Court's Order articulated a new heightened standard to be applied to Defendants' affirmative defense of good faith under Bankruptcy Code § 548(c). The Court rejected the objective standard of "inquiry notice" applicable to the good faith defense in "ordinary bankruptcies," concluding that in the "context of a SIPA trusteeship, where bankruptcy law is informed by federal securities law," a transferee's good faith defense "implies a lack of fraudulent intent" on the part of Defendants. Holding as a matter of law that securities investors have no inherent duty to inquire about their stockbrokers, the Court defined a heightened subjective standard of "willful blindness" that appears to be akin to a "conscious avoidance" standard derived from the criminal law context.

In addition to the nine transfer-related counts, the Trustee also asserted Counts Ten and Eleven that, respectively, seek to temporarily disallow Defendants' customer claims under Bankruptcy Code § 502(d) until the litigation against Defendants is resolved, and to equitably subordinate those customer claims for purposes of distribution based upon Defendants' inequitable conduct. In dismissing Count Ten, the Court held as a matter of law that § 502(d) is "overridden" in a SIPA proceeding by SIPA §78fff-2(c)(3). The Court sustained the Trustee's equitable subordination claim in Count Eleven, but held that the Trustee is required to make the same showing that is required for actual fraudulent transfers under § 548(a)(1)(A).

B. The Instant Motion

Because the Court dismissed Counts Two through Ten, the Trustee requests that the Court direct entry of final judgment as to those counts under Rule 54(b). If the Court declines to do so, the Trustee requests that the Court certify the Order under § 1292(b) for interlocutory appellate review the following controlling issues of law encompassed within the dismissal of those claims: (1) whether, as a matter of law and from the face of the pleadings, fraudulent transfers made by BLMIS to Defendants in furtherance of a Ponzi scheme without any actual securities trades taking place constitute "settlement payments" and/or "transfers" by a "stockbroker" "in connection with a securities contract" for the purposes of the safe harbor of § 546(e); (2) whether, as a matter of law, the safe harbor provision of § 546(e) bars recovery from immediate or mediate transferees pursuant to § 550 of transfers that are avoidable as against the initial transferee pursuant to § 548(a)(1)(A); and (3) whether, as a matter of law, § 502(d) of the Code is "overridden in the context of a SIPA trusteeship by Section § 78fff-2(c)(3) of SIPA."

A further controlling question of law that remains pending in the case that the Trustee requests to be certified under § 1292(b) is whether, in the context of a SIPA liquidation, a transferee's affirmative defense of good faith pursuant to §548(c) of the Code is governed by an objective inquiry notice standard applicable in "ordinary bankruptcies" or by a heightened standard of subjective willful blindness.

Argument

I. The Court should direct entry of final judgment under Rule 54(b) as to Counts Two through Ten of the Amended Complaint.

Rule 54(b) of the Federal Rules of Civil Procedure provides, in pertinent part, that "[w]hen an action presents more than one claim for relief . . . or when multiple parties are

involved, the court may direct entry of a final judgment as to one or more, but fewer than all, claims or parties only if the court expressly determines that there is no just reason for delay." Fed. R. Civ. P. 54(b).

To permit entry of final judgment under this Rule, there must be (1) multiple claims or multiple parties; (2) at least one claim finally decided within the meaning of 28 U.S.C. § 1291; and (3) an express determination by the district court that there is no just reason for delay. *See generally In re Air Crash at Belle Harbor, N.Y. on Nov. 12, 2001*, 490 F.3d 99, 108-09 (2d Cir. 2007). Certification under Rule 54(b) may be granted where there are interests of "sound judicial administration" and efficiencies to be served, *Curtiss-Wright Corp. v. Gen. Elec. Co.*, 446 U.S. 1, 8 (1980), or where there exists "some danger of hardship or injustice through delay which would be alleviated by immediate appeal." *Cullen v. Margiotta*, 811 F.2d 698, 711 (2d Cir. 1987) (overruled on other grounds). Under this standard, entry and certification of a final judgment as to Counts Two through Ten of the Trustee's Amended Complaint is appropriate now.

A. <u>The Court finally determined nine counts of an eleven-count Amended Complaint on grounds independent of the remaining claims.</u>

The first element of the Rule 54(b) test is met because the Amended Complaint involves multiple claims and multiple parties; the Trustee asserted 11 claims against 98 defendants. The second element is also met because Counts Two through Ten were finally decided. A judgment is final for the purposes of Rule 54(b) if it is an ultimate disposition on a cognizable claim for relief. *Curtiss-Wright*, 446 U.S. at 7. Here, the Order "ends the litigation of the [dismissed] claim[s] on the merits and leaves nothing for the court to do but execute the judgment." *Ginett v. Computer Task Group*, 962 F.2d 1085, 1094 (2d Cir. 1992).

"[A] district court should only enter final judgment if the claims are separable." *See Cullen*, 811 F.2d at 711; *Ross v. Thomas*, 09 Civ. 05631, 2010 WL 3952903, at *4 (S.D.N.Y. Oct. 7, 2010). Claims are separable for purposes of Rule 54(b) if they "can be decided independently of each other." *Ginett*, 962 F.2d at 1097 (quoting *Sears, Roebuck & Co. v. Mackey*, 351 U.S. 427, 436 (1956)). Such is the case here. The Court held that Counts Two through Nine were barred by the application of § 546(e) and that Count Ten was barred because § 502(d) does not apply in a SIPA proceeding; these are legal determinations independent of and unrelated to the remaining claims.

B. <u>No just reason for delay exists in entering final judgment and injustice would result if the Court does not do so.</u>

To enter final judgment under Rule 54(b), a district court must expressly find that there is no just reason for delay. *Ginett*, 962 F.2d at 1092. "[C]ourts do not simply evaluate whether there is a just reason for delay, but generally apply a balancing test that weighs multiple factors to determine whether directing entry of a final judgment is in the interest of sound judicial administration." *Ross*, 2010 WL 3952903, at *4. A district court therefore should consider the efficiency interests of both the district and appellate courts, as well as the balance of equities as to the parties. *See Smith v. Local 819 I.B.T. Pension Plan*, 291 F.3d 236, 240 (2d Cir. 2002); *Curtiss-Wright,* 446 U.S. at 8; *Ginett*, 962 F.2d at 1095.

Judicial efficiencies warrant the immediate entry of final judgment on the nine dismissed claims. Avoiding duplicative trials before the district court is a compelling efficiency consideration warranting entry of final judgment under Rule 54(b). *See, e.g., Advanced Magnetics, Inc. v. Bayfront Partners, Inc.*, 106 F.3d 11, 16 (2d Cir. 1997) (entering final judgment on certain claims under Rule 54(b), thus potentially avoiding "an expensive and duplicative trial"); *Trugman-Nash, Inc. v. N.Z. Dairy Bd.*, 954 F. Supp. 2d 733, 738 (S.D.N.Y.

1997) (granting Rule 54(b) judgment will allow immediate appeal to determine if certain "claims form a proper part of this case, [since] a single trial of all claims is preferable"). Absent an immediate appeal, the parties will proceed to trial in this Court on the remaining claims, and if the dismissals of the other claims for relief turn out to be in error, a second trial before this Court regarding fraudulent transfer liability under other provisions of the Code and the NYDCL will be required. This would be unnecessary if the Second Circuit had the opportunity to weigh in on those issues now.

As addressed more fully below, many of the Court's rulings on these issues are either matters of first impression or conflict with decisions of other courts within the Circuit. Obtaining appellate review before the first trial is essential to bringing precedential force to the value of the Trustee's claims and conclusively determining the relevant body of law to be applied to those claims. Preventing appellate review will likely result in lawsuits, based on a common nucleus of facts and for the same causes of action, being determined in opposite ways depending on the forum in which the particular adversary proceeding is heard. As this Court has expressed, consistency is needed for the 900-plus avoidance actions that have been brought by the Trustee. *See* Transcript of Withdrawal of Reference Hearing in *Picard v. Kelman Partners LP*, No. 11 Civ. 05513 (S.D.N.Y.) (JSR), pp. 19-20.

Whether the Order is affirmed or reversed, only appellate review can prevent a multiplication of errors in the numerous adversary proceedings that are pending before this Court and the bankruptcy court. A failure to provide appellate review immediately would work an injustice on all parties to the larger liquidation proceeding, of which this particular case is only one piece. *See In re Methyl Tertiary Butyl Ether Prod. Liab. Litig.*, No. 04 Civ. 03417, 2010 WL

1328249, at *4 (S.D.N.Y. Apr. 5, 2010) (holding that failure to provide appellate review in first case of multi-district litigation would work an injustice on all parties to MDL).

Permitting an appeal now will also be efficient for the Second Circuit. The appellate panel reviewing the claims certified pursuant to Rule 54(b) will be presented with legal issues that do not overlap with the merits of the claims remaining before this Court.[1] Nor will the trial court's disposition of the remaining claims render this appeal moot. *See, e.g.*, *Ginett,* 962 F.2d at 1095; *Hersch v. Gersten* (*In re Centennial Textiles, Inc.*), 220 B.R. 177, 181 (Bankr. S.D.N.Y. 1998). For these reasons, the Trustee respectfully requests that the Court direct entry of final judgment as to Counts Two through Ten of the Amended Complaint under Rule 54(b).

II. Alternatively, certification for interlocutory review under § 1292(b) is warranted.

Pursuant to § 1292(b), a court may certify an order for interlocutory appeal when: (1) the disputed ruling involves a controlling question of law; (2) substantial grounds for difference of opinion exist; and (3) an immediate appeal may materially advance the ultimate termination of the litigation. *See* 28 U.S.C. § 1292(b); *see also In re Enron Creditors Recovery Corp.,* 2009 WL 3349471, at *5 (S.D.N.Y. Oct. 16, 2009).

In the event that the Court does not view the claims as appropriate for entry of final judgment under Rule 54(b), the controlling issues of law encompassed within those claims

---

[1] The Trustee is requesting by way of this Motion that the Court certify for interlocutory appeal the issue of the "willful blindness" standard for recovery of actual fraudulent transfers, discussed more fully herein. This is the only issue that remains pending before this Court of which the Trustee has requested certification.

render the Order appropriate for interlocutory appeal pursuant to § 1292(b), as set forth above on Preliminary Section B and as discussed more fully herein.

A. The disputed rulings involve controlling questions of law that will materially affect the outcome of the litigation.

A disputed ruling involves a controlling question of law if the issue to be appealed is a "question of the meaning of a statutory or constitutional provision, regulation, or common law doctrine." *In re Contemporary Indus. Corp.*, 312 B.R. 898, 901 (D. Neb. 2004); *see also Bilello v. JPMorgan Chase Retirement Plan*, 603 F. Supp. 2d 590, 593 (S.D.N.Y. 2009) (finding controlling question of law when interpretation of statute was required). In addition, a question of law is "controlling" if reversal on that ground would terminate the action or would materially affect the litigation's outcome. *Klinghoffer v. S.N.C. Achille Lauro*, 921 F.2d 21, 24 (2d Cir. 1990).

The issues presented by the claims finally dismissed under the Order require the interpretation of §§ 502(d), 546(e), and 550 of the Bankruptcy Code, and SIPA § 78fff-2(c)(3). Because the Order dismissed claims as a matter of law on the face of the pleadings, they are classic controlling questions of law. Moreover, reversal on any of these grounds would materially affect the litigation's outcome, as discussed more fully below in Section II.C.

B. The Court's Order presents controlling issues of law as to which substantial grounds for difference of opinion exist.

For purposes of an interlocutory appeal, substantial grounds for difference of opinion as to controlling questions of law arise out of uncertainty as to whether the district court applied the correct legal standard in its order. *Picard v. Merkin* (*In re Bernard L. Madoff Inv. Sec. LLC*), No. 00 MC 00012, 2011 WL 3897970, at *10 (S.D.N.Y. Aug. 31, 2011). This factor "may be met when (1) there is conflicting authority on the issue, or (2) the issue is particularly difficult and of first impression for the Second Circuit." *Consub Delaware LLC. v. Schahin Engenharia*

Limitada, 476 F. Supp. 2d 305, 309 (S.D.N.Y. 2007) (citing *In re Lloyd's Am. Trust Funds Litig.*, No. 96 Civ. 01262, 1997 WL 458739, at *5 (S.D.N.Y. Aug. 12, 1997)).

1. The Court's conclusion that § 546(e) applies to transfers made in furtherance of Madoff's Ponzi scheme conflicts with Second Circuit and other authority.

This Court recognized in its Order that "Madoff and Madoff Securities were, at all times here relevant, engaged in a Ponzi scheme, by which customers of Madoff Securities, who were led to believe that their monies were being invested in profitable securities transactions, were paid their profits from new monies received from customers, *without any actual securities trades taking place*." *Picard v. Katz* (*In re Bernard L. Madoff Inv. Sec. LLC*), No. 11 Civ. 03605, 2011 WL 4448638, at *4 (S.D.N.Y. Sept. 27, 2011) (emphasis added). But despite finding that the transfers to Defendants were made in furtherance of a Ponzi scheme, and that no securities transactions occurred, this Court held, as a matter of law, that: (i) "all payments made by Madoff Securities to its customers" were "clearly" "settlement payments" within the meaning of § 546(e); and (ii) "any payment by Madoff Securities to its customers that somehow does not qualify as a 'settlement payment' qualifies as a 'transfer' made 'in connection with a securities contract.'" *Id.* at *2.

First, the Court's rulings on the application of the concepts of "settlement payment" and "securities contracts" as defined within § 546(e) are at odds with numerous authorities within the Second Circuit and beyond, including decisions rendered in this liquidation proceeding by the bankruptcy court. For example, because the transfers made by BLMIS to Defendants were not made in connection with the completion of any transactions in securities, this Court's decision concluding that all payments made by BLMIS to its customers were clearly "settlement payments" conflicts with the Second Circuit's decision in *Enron*. *See In re Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329, 2011 WL 2536101, at *7 (2d Cir. June 28,

2011) ("We, like our sister circuits, agree that in the context of the securities industry a 'settlement' refers to 'the completion of a securities transaction'") (internal citation and quotation omitted).

Likewise, the Court's ruling that any transfer not deemed a "settlement payment" qualifies as a "transfer" made by a "stockbroker" "in connection with a securities contract" conflicts with the decisions of Judge Lifland in other adversary proceedings in this action. *Picard v. Merkin* (*In re Bernard L. Madoff Inv. Sec. LLC*), 440 B.R. 243, 266-67 (Bankr. S.D.N.Y. 2010), and *Picard v. Peter B. Madoff* (*In re Bernard L. Madoff Inv. Sec. LLC*) (*"Madoff Family"*), --- F.3d ---, 2011 WL 4434632, at *15-*16 (Bankr. S.D.N.Y. Sept. 22, 2011).

In both *Merkin* and *Madoff Family*, the bankruptcy court held that it could not, as a matter of law, determine at the pleading stage either that Madoff was a "stockbroker . . . engaged in the business of effecting transactions in securities" or that the BLMIS customer account agreements relied on by defendants in those cases constituted "securities contracts" within the meaning of § 546(e). Because Madoff was not alleged to have purchased any securities for customer accounts, Judge Lifland found "dubious" the proposition that Madoff was a "stockbroker" under § 546(e), as courts have held that Ponzi scheme operators do not affirmatively "make securities transactions happen." *Merkin,* 440 B.R. at 267; *Madoff Family*, 2011 WL 4434632, at *15. Even if BLMIS was a "stockbroker" within the meaning of § 546(e), the court was unable, as a matter of law, to conclude that a "securities contract" ever existed within the meaning of the statute, finding that none of the agreements relied on by the defendants in those cases, by their terms, effected "the purchase sale or loan of a security." Rather, Judge Lifland concluded, "at most they merely authorize" Madoff to act on the defendants' behalf to

conduct trades in the future. *Merkin*, 440 B.R. at 267; *Madoff Family*, 2011 WL 4434632, at *16.

Judge Lifland applied established precedent in reaching these conclusions. Judge Wood of this District, in considering a request for interlocutory appeal in *Merkin*, found that there were no "substantial grounds for difference of opinion as to the correctness of the standards relied on by the Bankruptcy Court in its refusal—at the pleading stage—to dismiss on the grounds of [the defendants'] § 546(e) affirmative defense." *Merkin*, 2011 WL 3897970, at *12 (denying motion for interlocutory review of *Merkin* order).

In doing so, Judge Wood noted that the *Merkin* defendants cited "no decision in which a Ponzi scheme operator, who allegedly did not execute any trades, was deemed at the pleading stage to be a 'stockbroker' for purposes of § 546(e)." *Id.* at *12. Nor, Judge Wood noted, had the defendants cited to any "decision in which an agreement was deemed to be a 'securities contract' within the meaning of the Bankruptcy Code, where that agreement (a) merely authorized one party to conduct future trades on behalf of another party, and (b) did not, by its terms, effect the purchase, sale, or loan of a security between the parties." *Id.* at *25.

Accordingly, this Court's conclusion as a matter of law that "the kind of contract Madoff Securities had with its customers" constitutes a "securities contract" for purposes of § 546(e)—a determination that this Court made without having any of the ostensible securities contracts before it—conflicts with Judge Lifland's conclusions in *Madoff Family* and *Merkin*, as well as Judge Wood's determination that no substantial grounds for disagreement existed as to the correctness of Judge Lifland's holdings regarding those "contracts."

The Court's refusal to consider the plain language of § 546(e) in the context of the "overall structure and operation" of SIPA and the Bankruptcy Code also conflicts with the

Second Circuit's mandate that the "preferred meaning of a statutory provision is one that is consonant with the rest of the statute." *In re Bernard L. Madoff Inv. Sec.*, 2011 WL 3568936, at *7. Judges Marrero, Garrity, and Lifland have all considered the purpose underlying the safe harbor provision of § 546(e) within the context of the statutory structure and determined that it cannot plausibly be read to apply to transfers that were made in connection with bogus securities schemes—the precise circumstances here, as this Court itself acknowledges. As stated by Judge Lifland, "to extend safe harbor protection in the context of a fraudulent securities scheme would be to 'undermine, not protect or promote investor confidence . . . [by] endorsing a scheme to defraud SIPC,' and therefore contradict the goals of the provision." *Madoff Family*, 2011 WL 4434632, at *16 (internal citation and quotations omitted); *see also Merkin*, 440 B.R. at 267; *Mishkin v. Ensminger* (*In re Adler, Coleman Clearing Corp.*), 247 B.R. 51, 105 (Bankr. S.D.N.Y. 1999) (Garrity, J.); *Jackson v. Mishkin* (*In re Adler, Coleman Clearing Corp.*), 263 B.R. 406, 482-85 (S.D.N.Y. 2001) (Marrero, J.) (refusing to apply § 546(e) safe harbor to fraudulent scheme, as effect will diminish assets "available for equitable distribution to all other similarly situated creditors"); *see also Enron Corp. v. JPMorgan Sec., Inc.* (*In re Enron Corp.*), No. M-47, 2008 WL 281972, at *5 (S.D.N.Y. Jan. 25, 2008) (Daniels, J.).

Indeed, every other court to consider the matter, including circuit courts of appeal, has refused to apply § 546(e) to shield transfers made in furtherance of a pure fiction. *See, e.g.*, *Wider v. Wootton*, 907 F.2d 570, 573 (5th Cir. 1990) (finding application would "lend judicial support to 'Ponzi' schemes"); *Johnson v. Neilson* (*In re Slatkin*), 525 F.3d 805, 809, 816-19 (9th Cir. 2008) (holding Ponzi scheme operator is not "engaged in the business of effecting transactions in securities" for purposes of statute). While the Second Circuit has not yet spoken on this issue, it notably quoted Judge Marrero's opinion in *Adler*, in which he refused to apply

§ 546(e) to a fraudulent scheme, when noting that the Trustee's net equity method "avoid[s] placing some claims unfairly ahead of others." *In re Bernard L. Madoff Inv. Sec.*, 2011 WL 3568936, at *12 n.10.

That there is a substantial difference of opinion is made most plain by the differing articulations of the policy goals underlying the statutes at issue here. Judge Lifland held that applying the safe harbor to shield transfers Madoff made in connection with his fraud "would negate [SIPA's] remedial purpose by eliminating most avoidance powers granted to a trustee under SIPA." *Madoff Family*, 2011 WL 4434632, at *16; *Merkin*, 440 B.R. at 265-66. Yet this Court held that a Trustee's avoidance powers must be restricted to effectuate the policies of bankruptcy and securities law, both of which include SIPA. *Katz*, 2011 WL 4448638, at *2 (quoting *In re Enron Creditors Recovery Corp.*, 2011 WL 2536101, at *5) ("By restricting a bankruptcy trustee's power to recover payments that otherwise avoidable under the Bankruptcy Code, the safe harbor stands 'at the intersection of two important national legislative policies on a collision course—the policies of bankruptcy and securities law.'"). This conflict must be resolved.

Finally, the Court's ruling is inconsistent with the fundamental principles of statutory construction that a statute should be enforced according to its "plain language" unless such disposition would lead to an absurd result. *In re Enron Creditors Recovery Corp*., 2011 WL 2536101, at *9. Applying § 546(e) to shield from recovery fraudulent transfers made in furtherance of Madoff's Ponzi scheme "would have the absurd effect of treating fictitious and arbitrarily assigned paper profits as real and would give legal effect to Madoff's machinations," thus allowing "the whim of the defrauder" to control the "process that is supposed to unwind the fraud." *In re Bernard L. Madoff Inv. Sec.*, 2011 WL 3568936, at *5.

The Court's ruling, which is based on the plain language of the statute and extends to "all payments" made to BLMIS customers, would have the result of allowing anyone with a BLMIS account to invoke the § 546(e) safe harbor, including Madoff's own family members or investors who were willfully blind to or had actual knowledge of the fraud. *Compare Madoff Family*, 2011 WL 4434632, at *16 ("[I]t defies credulity that the [Madoff family member defendants], who are insiders based on the facts alleged, were ever contemplated to be the parties eligible to invoke the safe harbor provision of § 546(e)"). The Order thus permits untenable results. Because a substantial difference of opinion exists as to the correct legal standards governing the § 546(e) safe harbor, this Court should certify it now for interlocutory review.

2. The Court's application of § 546(e) to bar all recoveries from subsequent transferees is an issue of first impression.

The application of § 546(e) to bar the Trustee's recovery of all subsequent transfers in a Ponzi scheme pursuant to § 550 is an issue of first impression in the Second Circuit. In fact, the Trustee has located no reported decisions that come to the same conclusion as this Court.

Under the exceptions set forth in § 546(e), the Court limited the Trustee's avoidance powers to intentional fraudulent transfers under § 548(a)(1)(A). The Court further held, however, that these otherwise avoidable transfers could not be *recovered* from subsequent transferees by the Trustee. The Trustee respectfully submits that this conclusion misapprehends the interplay between §§ 546 and 550(a) of the Code.

Section 546 limits a trustee's avoidance powers. Section 550(a), on the other hand, deals with a trustee's ability to *recover* transfers, whether initial or subsequent, "to the extent that a transfer is avoided under section . . . 548 . . . of this title." Because the Court sustained the Trustee's § 548(a)(1)(A) avoidance count, the plain language of § 550(a) permits the Trustee to seek to recover these transfers from subsequent transferee defendants. In other words, as a pure

question of law, the Court has held that the Trustee may *avoid* initial fraudulent transfers pursuant to § 548(a)(1)(A) under the enumerated exception to avoidance in § 546(e), but may not *recover* these very same transfers from subsequent transferees, effectively reading § 550(a) out of the Bankruptcy Code, notwithstanding the plain language of the statutes. Certification of this issue for immediate appeal is particularly appropriate because the Court's Order not only has the potential effect of stymying the Trustee's ability to recover hundreds of millions of dollars of avoidable transfers in this case as well as in hundreds of other cases arising out of Madoff's Ponzi scheme, but moreover, could potentially be argued to immunize from suit all subsequent transferees in future SIPA liquidation proceedings.

Resolution of this fundamental matter is ripe for interlocutory appeal because it is an issue of first impression in this Circuit. *Klinghoffer*, 921 F.2d at 24-25 (granting petition for permission to appeal and acknowledging "controlling question of law" when issues are of first impression).

3. This Court's holding that § 502(d) is overridden by SIPA § 78fff-2(c)(3) is a matter of first impression in this Circuit.

Similarly, this Court's ruling that § 502(d) is overridden by SIPA § 78fff-2(c)(3) is a matter of first impression in this Circuit and elsewhere. The Court found that SIPA § 78fff-2(c)(3) provides "that securities customers who have received avoidable transfers may still seek to pursue those transfers as creditors of the SIPA estate." *Katz*, 2011 WL 4448638, at *6. Nothing in SIPA §78fff-2(c)(3) provides customers with an affirmative right to "seek to pursue" a claim for fraudulent or preferential transfers of customer property they received. Nor is such a claim provided for by other sections of SIPA or the Bankruptcy Code.

By its plain language, SIPA section 78fff-2(c)(3) empowers a trustee to recover transfers of customer property wrongfully transferred and "*[f]or the purposes of such recovery* . . . if such

transfer was made to a customer for his benefit, *such customer shall be deemed to be a creditor*[.]" SIPA § 78fff-2(c)(3) (emphasis added). As Collier's on Bankruptcy explains, the purpose of Section 78fff-2(c)(3) was to expand, not limit, a trustee's avoidance powers by deeming "customer property" to have been property of the debtor:

> A customer receiving a voidable transfer is deemed to be a creditor for purposes of avoidance, and the property so transferred is deemed to have been property of the debtor. The customer is not an actual creditor, and, under virtually all state and federal securities laws, the property does not belong to the debtor prior to transfer. The purpose of this legal fiction is to enable the trustee to fit the transfer into the provisions of the avoidance sections of the [Bankruptcy] Code. The legal fiction prevents a customer from using a technical reading of the avoidance provisions of the [Bankruptcy] Code to retain securities that would otherwise be recoverable by the trustee. The overall purpose of . . . 15 U.S.C. § 78fff-2(c)(3) is to prevent one or more customers from depriving other customers of assets by keeping these assets out of the pool available for distribution to customers on a ratable basis.

6 *Collier on Bankruptcy* ¶ 749.02[1] (16th ed. 2011). Thus, under SIPA § 78fff-2(c)(3), customers are deemed creditors *solely* for the purpose of allowing the Trustee to recover transfers of customer property to the extent such transfers are voidable or void under the provisions of title 11.

This Court's interpretation of § 78fff-2(c)(3) is a matter of first impression in this Circuit, and stands in contrast with existing authority within this District which recognizes that § 502(d) is available to a trustee in a SIPA proceeding. *See, e.g.*, *Madoff Family*, 2011 WL 4434632, at *19 (holding that Trustee adequately pled his claim to disallow defendants' SIPA claims under § 502(d); noting that the purpose of the section is to "preclude entities that have received voidable transfers from sharing in the distribution of assets unless and until the voidable transfer has been returned to the estate.") (quoting *In re Mid. Atl. Fund, Inc.*, 60 B.R. 604, 609 (Bankr. S.D.N.Y. 1986).

The Court's Order, which created for the first time a claim by customers for the fraudulent transfers they received, is expressly contrary to the overall purpose of the statute, which "is to prevent one or more customers from depriving other customers of assets by keeping these assets out of the pool available for distribution to customers on a ratable basis." 6 *Collier on Bankruptcy* ¶ 749.02[1] (16th ed. 2011).[2] The Court's ruling with regard to SIPA § 78fff-2(c)(3) and § 502(d) of the Code is therefore also contrary to the Second Circuit's "net equity" decision, wherein the Court interpreted the net equity provision of SIPA in a manner that was harmonious with the Trustee's avoidance powers and avoided "placing some claims unfairly ahead of others." *In re Bernard L. Madoff Inv. Sec.*, 2011 WL 3568936, at *12 n.10.

As such, the Court's Order presents important issues in this Circuit that have far reaching consequences for the efficient functioning of SIPA proceedings and, therefore, requires immediate appellate review. *See also In re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 03288, 2003 WL 22953644, at *5 (S.D.N.Y. Dec. 16, 2003) (finding that issue was one of first impression where no court of appeals directly examined it).

---

[2] *See also Hill v. Spencer S&L Ass'n* (*In re Bevill, Bresler & Schulman, Inc.*), 94 B.R. 817, 826-827 (D.N.J. 1989) (noting that "[a]bsent these fictions, virtually all securities transactions would be immune from the trustee's avoidance power, frustrating SIPA's purpose of equitable distribution.") (citing Matter of Bevill, Bresler & Schulman, Inc., 83 B.R. 880, 893-894 (D.N.J. 1988) ("To promote equality of distribution to similarly situated claimants, the trustee is permitted, under 15 U.S.C. § 78fff-2(c)(3), to recover securities that would have been part of the fund of customer property but for a prior transfer to a customer.")).

C. **<u>An immediate appeal from the Court's Order is warranted given its unusual significance to more than 900 other actions.</u>**

The "institutional efficiency of the federal court system is a chief concern underlying 1292(b)," and its application is warranted in exceptional cases to avoid "protracted and expensive litigation." *Consol. Edison, Inc. v. Northeast Util.,* 318 F. Supp. 2d 181, 196 (S.D.N.Y. 2004) (citation omitted). Where "an appeal would facilitate the expeditious resolution of the case," applications for leave to appeal "should be liberally granted." *In re Enron Creditors Recovery Corp.*, 2009 WL 3349471, at *7 (citing *In re Manville Forest Prod. Corp.,* 31 B.R. 991, 995 n.5 (S.D.N.Y. 1983)). Even where an immediate appeal will not "advance the time for trial or shorten the time required for trial" for one lawsuit, providing "certainty as to [the claims] will help streamline the litigation for trial and on appeal." *Consol. Edison, Inc.*, 318 F. Supp. 2d at 197.

Certification for immediate appeal is particularly appropriate where a court's ruling is of unusual significance, including instances where other pending cases will require resolution of similar issues. *Kramer v. Lockwood Pension Services, Inc.*, 653 F. Supp. 2d 354, 397-98 (S.D.N.Y. 2009) (noting interlocutory appeals should be granted for "consideration [of a] case . . . of unusual significance, one in which a ruling is of practical importance going well beyond run-of-the-mill concerns of parties before the Court"); *Brown v. Bullock*, 294 F.2d 415, 417 (2d Cir. 1961) (Friendly, J.) (explaining that interlocutory appeal was granted because "such a determination was likely to have precedential value for a large number of other suits . . . now pending in the Southern District [of New York]); *Romea v. Heiberger & Assoc.*, 988 F. Supp. 715, 717 (S.D.N.Y. 1998) (concluding that interlocutory review was appropriate where questions presented were of broad applicability to significant volume of litigation in New York).

Here, certification of the Court's Order is warranted because until the Second Circuit provides guidance, the rulings will affect the Trustee's 900-plus avoidance actions arising out of Madoff's fraud. Defendants in the Trustee's other adversary proceedings have already attempted to invoke the Court's Order as a defense to the Trustee's claims. Many if not all of the 900-plus cases will be impacted by the uncertainty created by the conflict between this Court's rulings and the decisions of other courts within this district. There is little likelihood that the lawsuits will settle under these circumstances; in fact, it is a virtual certainty that the parties will continue to challenge rulings on these issues in every court until the Second Circuit renders a final determination on them. An immediate appeal will provide needed certainty to the parties, avoid unnecessary litigation, and expedite the ultimate resolution of these cases. *See In re Fosamax Prod. Liab. Litig.*, No. 06 MD 01789, 2011 WL 2566074, at *10 (S.D.N.Y. June 29, 2011) (holding that "extraordinary circumstances warranting interlocutory appellate review" exist where such review would prevent additional trials and materially advance the progress of 100 related litigations).

III. Interlocutory appeal is warranted to resolve the conflict arising from this Court's ruling that imposes a heightened subjective standard of "willful blindness" to Defendants' good faith defense.

Independent of the grounds for entry of final judgment as to the dismissed claims under Rule 54(b) or certification of the issues implicated by those claims under § 1292(b), the Trustee also seeks certification pursuant to § 1292(b) on an issue that remains pending before the Court. Contrary to numerous authorities, the Court held for the first time that a heightened subjective standard of willful blindness governs the Code's § 548(c) affirmative defense of good faith in the context of a SIPA liquidation. *Katz*, 2011 WL 4448638, at *5-*6. This disputed ruling satisfies all of the factors for certification, and the Trustee respectfully requests that the Court certify this determination for interlocutory appeal.

First, the appropriate legal standard governing the good faith defense available under § 548(c) to investors in a SIPA liquidation is a controlling question of law because it is a "pure question of law that the reviewing court could decide quickly and cleanly without having to study the record" and "would materially affect the litigation's outcome." *See Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec., LLC*, No. M-47, 2010 WL 185102, at *1 (S.D.N.Y. Jan. 11, 2010) (quoting *In re WorldCom, Inc.*, No. M-47, 2003 WL 21498904, at *10 (S.D.N.Y. June 30, 2003)).

As to the second prong, a substantial ground for difference of opinion exists with respect to this Court's imposition of a heightened standard because there is a substantial conflict of authority with respect to this issue. *See Merkin*, 2011 WL 3897970, at *10 (noting that a genuine doubt as to whether court applied correct legal standard demonstrates substantial ground for difference of opinion). All courts in this District—with the exception of this Court—and all of the circuit courts of appeal to date that have addressed this issue have applied an objective, "reasonably prudent" standard of inquiry notice and diligent investigation to a transferee's good faith defense under § 548(c). *See, e.g.*, *Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, LLC* (*In re Bayou Group LLC*), 439 B.R. 284, 310-13 (S.D.N.Y. 2010) (reviewing dozens of cases in which an objective standard was applied); *In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 23 (S.D.N.Y. 2007); *Jobin v. McKay* (*In re M&L Bus. Mach. Co., Inc.*), 84 F.3d 1330, 1334, 1335-38 (10th Cir. 1996). The Court's further conclusion, that different standards govern a transferee's good faith affirmative defense depending on whether a SIPA or "ordinary bankruptcy" trustee brings the avoidance action, is also matter of first impression. *Katz*, 2011 WL 4448638, at *5.

In the SIPA context, the Court rejected application of the objective "inquiry notice" standard to a transferee-defendants' good faith defense, finding that, as a matter of law, a securities investor has no "inherent duty to inquire about his stockbroker" even "when confronted with suspicious circumstances." *Id.* There is, however, substantial conflicting and controlling authority within this Circuit on that issue, including decisions of the Second Circuit itself, which have held that, as a matter of law, investors *do* have a duty to inquire when confronted with suspicious circumstances, and that the diligence of the investors' inquiry is measured by an objective, not a subjective, test. *See, e.g., Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 350 (2d Cir. 1993) (holding inquiry notice standard is objective in securities fraud context); *Crigger v. Fahnestock & Co. Inc.*, 443 F.3d 230, 236 (2d Cir. 2006); *Barron Partners LP v. Lab123, Inc.*, No. 07 Civ. 11135, 2008 WL 2902187, at *5 n.3 (S.D.N.Y. July 25, 2008) (Rakoff, J.) (in securities fraud case, this Court noted that "[r]easonable reliance entails a duty to investigate the legitimacy of an investment opportunity where plaintiff was placed on guard or practically faced with the facts") (internal citation omitted).

The Court's heightened standard of "willful blindness" also creates another conflict with authorities within this Circuit by effectively imposing an additional element of proof to fraudulent conveyance claims, requiring the Trustee to prove the Defendants' "scienter," meaning that in order for the Trustee to recover the Defendants' principal the Defendants must have been willfully blind to BLMIS' fraud and/or had an intent to defraud. *Katz*, 2011 WL 4448638, at *5. The heightened standard of "willful blindness" set by the Court's Order appears to rise to a level akin to the criminal standard for "conscious avoidance," a means commonly used to prove criminal defendants' actual knowledge of facts where such actual knowledge is a

statutory element of a crime. *Id.* (citing *United States v. Rodriguez*, 983 F.2d 455 (2d Cir. 1993) (criminal narcotics case)).

By effectively requiring the Trustee to prove as part of his fraudulent conveyance claims that the Defendants were willfully blind to BLMIS' fraud or had the intent to defraud, the Court's Order is in direct conflict with other decisions in this District, which have expressly held that a transferee's intent to defraud is not an element of fraudulent conveyance claims under the Bankruptcy Code or the NYDCL. *See, e.g.*, *In re Bayou Group LLC*, 439 B.R. at 304; *Merkin*, 2011 WL 3897970, at *4-*6; *Gowan v. The Patriot Grp. LLC* (*In re Dreier*), 452 B.R. 391, 432-33 (Bankr. S.D.N.Y. 2011).

Finally, an immediate appeal will provide certainty as to the claims and "will help streamline the litigation for trial and on appeal." *Consol. Edison, Inc.*, 318 F. Supp. 2d at 197. The standard governing the affirmative defense of good faith to the Trustee's fraudulent conveyance claims is at issue in dozens of other cases involving hundreds of additional defendants. An expedited appeal from this issue will provide much needed clarity and will promote judicial economy for these and other related litigations.

Conclusion

For the reasons stated above, the Trustee respectfully requests that this Court (i) direct entry of judgment as to Counts Two through Ten of the Amended Complaint under Fed. R. Civ. P. 54(b), and certify the Court's September 27, 2011 Order for interlocutory appeal under 28 U.S.C. § 1292(b) as to the controlling question of law concerning the applicable standard governing a transferee's affirmative good faith defense under 11 U.S.C. § 548(c) in a SIPA liquidation proceeding; (ii) alternatively, certify the entirety of the Court's September 27, 2011 Order for interlocutory appeal under 28 U.S.C. § 1292(b); and (iii) grant such other relief as the Court may deem just and proper.

Date: October 7, 2011
New York, New York

By: */s/ David J. Sheehan*

BAKER & HOSTETLER LLP
45 Rockefeller Plaza
New York, New York 10111
Telephone: (212) 589-4200
Facsimile: (212) 589-4201
David J. Sheehan
Email: dsheehan@bakerlaw.com
Fernando A. Bohorquez, Jr.
Email: fbohorquez@bakerlaw.com
Regina L. Griffin
Email: rgriffin@bakerlaw.com
Seanna R. Brown
Email: sbrown@bakerlaw.com

Attorneys for Irving H. Picard, Trustee for the Substantively Consolidated SIPA Liquidation of Bernard L. Madoff Investment Securities LLC and Bernard L. Madoff

300181946