

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

In re:

BERNARD L. MADOFF,

Debtor.

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. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

Adv. Pro. No. 10-5287 (BRL)

Case No. 11-Civ-03605 (JSR)

**MEMORANDUM OF LAW IN SUPPORT OF THE
TRUSTEE'S RIGHT TO A JURY TRIAL**

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In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of common law.

— U.S. Const. Amend. VII

PRELIMINARY STATEMENT

Saul Katz, Fred Wilpon, and the other Defendants ask this Court to deprive the Trustee of the most fundamental right in American jurisprudence in order to avoid having their liability determined by a jury of their peers. The right to a jury trial is a fundamental right of a litigant in an Article III court seeking monetary relief. The Seventh Amendment guarantees a party a trial by jury in an action grounded in law. Here, the Trustee’s causes of action that seek to recover a money judgment are “unquestionably legal.” *Dairy Queen, Inc. v. Wood*, 369 U.S. 469, 476 (1962). Therefore, the Trustee’s right to a jury trial on his fraudulent transfer causes of action is protected by the Seventh Amendment. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 64 (1989) (holding that fraudulent transfer claims under section 548 of the Bankruptcy Code are legal claims and can be tried to a jury). The Defendants cannot curtail the Trustee’s constitutional right to a jury trial.

Nor can the Defendants cherry pick the features of Article I and Article III courts that suit them. Only a few months ago, the Defendants succeeded in withdrawing this action from the Bankruptcy Court. The Defendants have invoked Article III, arguing that the issues underlying these causes of action are beyond the jurisdiction of the Bankruptcy Court. However, because the Seventh Amendment protects the Trustee’s right to a jury trial on the legal claims withdrawn by the Court, the Defendants cannot now argue that the process of determining proofs of claim, which is before the Bankruptcy Court, somehow affects the legal nature of these causes of

action. Equitable considerations tied to the determination of proofs of claim are not before this Court and thus have no bearing on the Trustee’s right to have a jury determine the issues here.

Despite the Defendants’ trepidation to submit to a jury’s judgment, the Trustee’s constitutional right remains. Nothing here impedes on this fundamental right. The Trustee has timely demanded a jury trial. A jury must decide whether the Defendants impermissibly profited from Madoff’s fraud and whether these transfers of other people’s money should be returned to the estate.

ARGUMENT

I. THE TRUSTEE’S RIGHT TO A JURY TRIAL IN THIS ACTION IS INVIOABLE

The Seventh Amendment guarantees a party’s right to a jury trial of legal claims. “[W]here the value in controversy . . . exceed[s] twenty dollars,” a party’s “right of trial by jury” is sacrosanct. U.S. Const. amend. VII. Courts must “jealously guard” a party’s right to a jury trial of legal claims as a “fundamental feature of [the American] system of federal jurisprudence.” *Brown v. Sandimo Materials*, 250 F.3d 120, 127 (2d Cir. 2001) (quoting *Jacob v. City of New York*, 315 U.S. 752, 752 (1942)). Attempts to abrogate a party’s right to a jury trial must be “scrutinized with the utmost care,” *Dimick v. Schiedt*, 293 U.S. 474, 486 (1934), and must be rejected whenever legal rights and remedies, enforceable in an action for damages in courts of law, are implicated. *Curtis v. Loether*, 415 U.S. 189, 194 (1974); *see also Chauffeurs, Teamsters & Helpers, Local No. 391 v. Terry*, 494 U.S. 558, 565 (1990); *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 501 (1959).

The Trustee has demanded a jury trial of his fraudulent transfer claims. The statement that “[t]he right of trial by jury as declared by the Seventh Amendment to the Constitution—or as provided by a federal statute—is preserved to the parties inviolate,” reflects this protection of a

litigant's fundamental jury trial right. Fed. R. Civ. P. 38(a). The Defendants, who moved to withdraw the reference of this case to an Article III court, now seek to do away with the Trustee's right to a jury trial of Count One of his Amended Complaint.

A. The Trustee's Fraudulent Transfer Action is an Action at Law

The Trustee has the right to a jury trial of Count One of his Amended Complaint, which seeks to recover fraudulent transfers from many of these Defendants.¹ See *Granfinanciera*, 492 U.S. at 64. As in *Granfinanciera*, because the Trustee's fraudulent transfer action seeks a monetary judgment, it is an action at law, not in equity, and must be tried by a jury:

[A] plaintiff is entitled to return of any funds transferred in violation of 11 U.S.C. § 548, and because a judge lacks equitable discretion to refuse to enter an award for less than the amount of the transfer, any distinction that might exist between "damages" and monetary relief under a different label is purely semantic, with no relevance to the adjudication of [a] Seventh Amendment claim.

Id. at 49 n.7. See also, e.g., *Pernell v. Southall Realty*, 416 U.S. 363, 370 (1974) ("[W]here an action is simply for the recovery . . . of a money judgment, the action is one at law."); *Dairy Queen*, 369 U.S. at 476 ("[I]nsofar as the complaint requests a money judgment it presents a claim which is unquestionably legal."). In *Granfinanciera*, the Supreme Court established that fraudulent transfer actions are legal in nature because: (1) similar claims were brought in courts of law before the merger of English courts of law and equity; (2) such claims seek monetary, not equitable, relief; and (3) Congress did not eviscerate the legal nature of fraudulent transfer claims by permitting them to be adjudicated in bankruptcy court. 492 U.S. at 43, 49 n.7, 52.

¹ The Trustee's motion seeking certification of this Court's Order dismissing Counts Two through Ten of the Trustee's Amended Complaint is currently pending. Notice of Motion to Direct Entry of Final Judgment Under Fed. R. Civ. P. 54(b) and for Certification Under 28 U.S.C. § 1292(b) filed on Oct. 7, 2011. The majority of the dismissed counts sought to avoid and recover fraudulent and preferential transfers, sought monetary damages, and were therefore claims at law that would be triable to a jury.

“[P]urely taxonomic changes” to a legal claim, such as the Bankruptcy Code’s use of common law principles to establish a cause of action for the recovery of fraudulent transfers under section 548, do not “eliminate a party’s Seventh Amendment right to a jury trial.” *Id.* at 60-61. A party’s right to a jury trial of fraudulent transfer claims therefore remains. *Id.* at 43, 49 n.7, 52.

II. THE TRUSTEE’S FRAUDULENT TRANSFER ACTION MUST BE TRIED TO A JURY

The Seventh Amendment protects the Trustee’s right to a jury trial of his fraudulent transfer causes of action against each of the Defendants. This Court, upon the Defendants’ motion, withdrew the reference of the Trustee’s action. Because the Trustee asserts fraudulent transfer causes of action in an Article III court, he has an absolute right to a jury trial.

The process of determining proofs of claim, which remains before the Bankruptcy Court, does not affect the Trustee’s right to a jury trial. Rather, the determination of these proofs of claim, would depend upon, not dictate, the outcome of this proceeding. In moving to withdraw the reference, the Defendants demanded that this Court adjudicate the Trustee’s action. *See Mem. of Law in Support of the Sterling Defendants’ Mot. to Withdraw the Reference, No. 11 Civ. 03605 (JSR) (S.D.N.Y. filed May 26, 2011).*

Second Circuit law preserves the Trustee’s right to a jury trial even if the Trustee commences his action in the Bankruptcy Court. *See Germain v. Conn. Nat’l Bank*, 988 F.2d 1323, 1329-30 (2d Cir. 1993).

A. This Court’s Adjudication of the Trustee’s Fraudulent Transfer Action Is an Exercise in Law, Not Equity

The withdrawal of the reference has divorced the adjudication of the Trustee’s fraudulent transfer causes of action from the administration of customer claims in the bankruptcy proceeding. In adjudicating these causes of action, this Court will determine the Trustee’s legal

remedies against the Defendants. *Granfinanciera*, 492 U.S. at 49. The Trustee's fraudulent transfer action, like that in *Granfinanciera*, is based in section 548 of the Bankruptcy Code.

The claims determination process does not affect this analysis because that process is pending in the Bankruptcy Court. The hypothetical effect of a fraudulent transfer action on the determination of the Defendants' claims against the estate is not before this Court.² This analysis is entirely consistent with the Supreme Court's decision in *Katchen v. Landy*, 382 U.S. 323 (1966) and its progeny.³ Those cases do not control because they involved actions proceeding in the Bankruptcy Court. However, their reasoning explains why the Trustee has a right to jury trial.

The *Katchen* Court held that an avoidance action becomes part of the claims determination process *because* it operates as an objection to that claim under the predecessor to section 502(d) of the Bankruptcy Code. *Id.* at 334. Congress expressly commanded the bankruptcy court to determine proof of claims, and that process cannot be delayed by a lengthy trial of the interrelated legal action for a money judgment. *Id.* Furthermore, once the bankruptcy judge determines the underlying facts, a jury trial on the legal elements "would be a meaningless gesture." *Id.* at 334. The bankruptcy judge's findings would be *res judicata* on all relevant facts. *Id.* Thus, allowing the bankruptcy judge to determine the equitable element of an action promotes judicial economy. *Id.* at 334-35.

² Moreover, while the Trustee disagrees with this Court's ruling that the Bankruptcy Court lacks the ability to disallow customer claim under section 502(d) in a SIPA proceeding, he notes that where that claim has been dismissed, the fraudulent transfer action cannot be part of the claims determination process, and therefore cannot be deemed equitable by virtue of Defendants' proofs of claim. *See Katchen*, 382 U.S. at 333-34.

³ *See Langenkamp v. Culp*, 498 U.S. 42, 43 (1990); *Bankr. Servs., Inc. v. Ernst & Young (In re CBI Holding Co.)*, 529 F.3d 432, 466 (2d Cir. 2008).

Unlike in *Katchen*, the trial of the Trustee’s legal action in this Court is far from a “meaningless gesture.” In fact, the opposite is true: factual findings in this proceeding will be *res judicata* in the claims determination proceedings in the Bankruptcy Court. In this case, the determination of the Defendants’ customer claims is not before this Court. That process will occur in due course in the main SIPA⁴ proceeding before Judge Lifland.

Nor are *Katchen*’s forum shopping concerns present here. The *Katchen* Court reasoned that because the creditor-defendant submitted himself to the jurisdiction of the bankruptcy court by filing a proof of claim, he could not then seek refuge in an Article III court on issues arising out of his proof of claim. *Id.* at 333 n.9. This rationale cannot be used against the Trustee. The Trustee’s fraudulent transfer action is already before an Article III court. This fact is of the Defendants’ making, not the Trustee’s.

B. The Trustee Has Not Waived His Right to a Jury Trial

Like any other litigant in an action at law, a bankruptcy trustee has the right to a jury trial. The Second Circuit has specifically rejected the argument that the filing of a bankruptcy petition constitutes a waiver of a trustee’s right to a jury trial in actions at law. *Germain*, 988 F.2d at 1329-30; *see also In re Jensen*, 946 F.2d 369, 374 (5th Cir. 1991) (“Nor do we find that the petition for bankruptcy somehow ‘waives’ the debtor’s jury trial right.”); *Billing v. Ravin, Greenberg & Zackin, P.A.*, 22 F.3d 1242, 1251 n.14 (3d Cir. 1994) (rejecting the theory that the bankruptcy petition waives the trustee’s right to a jury trial where otherwise available).⁵

⁴ 15 U.S.C. §§ 78aaa, *et seq.*

⁵ While a creditor is sometimes said to “waive” its right to a jury trial in bankruptcy court by filing a proof of claim against the estate, this is a misuse of terminology. A creditor’s loss of its right to a jury trial in those circumstances is not founded on waiver. *Granfinanciera*, 492 U.S. at 59 n.14 (“It warrants emphasis that this rationale differs from the notion of waiver. . . .”); *Germain*, 988 F.2d at 1329 (stating that loss of jury right through filing a proof of claim is not based on waiver). To the extent a creditor’s forfeiture of its jury right is considered “waiver,”

III. COMMON FACTUAL ISSUES MUST BE TRIED TO A JURY

Even if the causes of action against the Defendants who filed proofs of claims are considered equitable, the Trustee's right to a jury trial against those Defendants who did not file proofs of claim is unassailable. When legal claims, such as the Trustee's fraudulent transfer claims, and equitable issues, such as the Trustee's determination of the Defendants' proofs of claim, are grounded in common factual issues, the legal claims must first be tried to a jury.

Heyman v. Kline, 456 F.2d 123, 130 (2d Cir. 1972) (“When legal and equitable claims are tried together, common questions of fact must be decided by a jury in order to preserve the integrity of the Seventh Amendment guarantee.”); *see also Beacon Theatres*, 359 U.S. at 508 (reversing denial of demand for a jury in a case involving a mix of legal and equitable causes of action); *Notinger v. Brown (In re Simply Media, Inc.)*, No. 06-11539 (JMD), 2007 WL 4264514, at *3 (Bankr. D.N.H. Nov. 28, 2007) (stating that if a legal claim and an equitable claim have common issues of fact, the legal claim must be decided first by a jury).

Where there is a right to a jury trial, judicial determination of factual issues common to a related equitable claim violates the Seventh Amendment. This is because such determinations would be binding in the jury trial, thereby eviscerating the jury trial right. *See In re Simply Media*, 2007 WL 4264514, at *5 (“[An] action must be structured and tried in a manner that preserves the right to a jury trial with respect to the legal claim and issues of common facts must be tried to a jury with the bankruptcy court being bound by those findings.”) (quoting *Magers v. Bonds (In re Bonds Distrib. Co.)*, No. 98-6044 (WLS), 2000 WL 33682815, at *4 (Bankr. M.D.N.C. Nov. 15, 2000); *see also Reliability Research, Inc. v. Computer Assocs. Int'l, Inc.*, 851

this does not apply to a trustee. *Germain*, 988 F.2d at 1330 n.8 (“We do not agree[] that each time a creditor is deemed to have waived the right to a jury trial, the same presumption must hold for the trustee.”).

F. Supp. 58, 61 (E.D.N.Y. 1993) (partially denying motion to strike plaintiff's jury demand and noting that “[i]n order to preserve the right to a jury trial where legal and equitable claims overlap, the jury must not only decide the legal claims, but also must determine issues of fact common to both.”) (internal citations omitted).

Thirty-nine of the Defendants have not filed a proof of claim in the SIPA proceeding. The Trustee has sued four of these Defendants under section 548(a)(1)(A) of the Bankruptcy Code.⁶ Two of these Defendants, Sterling American Advisors II LLP and Sterling Acquisitions LLC are entities owned in part by Saul Katz, Fred Wilpon, and other Defendants. In addition, Madoff used Sterling American Property V LP, another Defendant that did not file a proof of claim, to invest in Sterling's real estate ventures. The legal claims against these Defendants involve numerous issues of fact common to the claims against the other Defendants. A jury must decide:

- Whether BLMIS was operating as a Ponzi scheme when it made fraudulent transfers to the Defendants;
- Whether BLMIS made fraudulent transfers to the Defendants with actual intent to hinder, delay, or defraud creditors;
- Whether the Defendants received the contested transfers from BLMIS in good faith (given, for example, their investigation of Ponzi insurance); and
- Whether the Sterling Partner Defendants' lack of good faith can be imputed to all other Defendants under principles of agency, equitable ownership, and/or piercing of the corporate veil.

These facts are common to all Defendants and underlie both the legal and equitable claims involved in the Trustee's action. The determinations of these facts cannot be siloed.

⁶ See Decl. of Matthew Cohen, dated October 14, 2011, ¶¶ 2-3, Ex. A.

CONCLUSION

For all of the foregoing reasons, the Trustee is entitled to a jury trial in this action.

Dated: New York, New York
October 14, 2011

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