Irving H. Picard v. Saul B. Katz et al
Doc. 86

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

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Defendants respectfully submit this memorandum of law in support of their motion for summary judgment, pursuant to Federal Rule of Civil Procedure 56, dismissing the remaining claims alleged in the Trustee's March 18, 2011 amended complaint ("Complaint"). Because there is no genuine dispute as to any material fact, Defendants are entitled to judgment as a matter of law.

PRELIMINARY STATEMENT

The Trustee seeks avoidance under 11 U.S.C. § 548(a)(1)(A) of withdrawals from Defendants' accounts at Bernard L. Madoff Investment Securities LLC ("BLMIS"), a registered broker, and to subordinate Defendants' claims against BLMIS. This Court has ruled that both require a showing of "willful blindness" to BLMIS' Ponzi scheme on the part of each Defendant.

Defendants have offered proof, including the sworn statements of the partners of Sterling Equities ("Sterling Partners"), that Defendants trusted their broker, Bernard L. Madoff ("Madoff"), and never suspected him of any fraud, let alone a Ponzi scheme. The Trustee has no evidence to support his Complaint. He cannot show that any Defendant (1) *subjectively believed* that there was a *high probability* that Madoff was running BLMIS as a Ponzi scheme or (2) took *deliberate action* to avoid learning the truth.

Quite to the contrary, the evidence demonstrates that, based on substantial and consistent external information, and their own experience, Defendants believed that Madoff was what he appeared to be—a highly successful broker, esteemed in the investment community. The Sterling Partners had examined his strategy and found it conservative and safe. Evidencing their complete lack of any suspicion, they regularly

offered their Madoff accounts as collateral for loans from major financial institutions, voluntarily exposing their holdings to expert scrutiny. These institutions deemed their Madoff holdings to be valuable and Madoff's strategy sound.

The evidence also shows that the Sterling Partners are honorable men. They worked hard for many years and became very successful. They entrusted Madoff with an enormous amount of their money, giving him discretion over their accounts. Their families, close friends, charities, and businesses did the same. Why would they have risked it all if they had believed that there was *any* possibility that Madoff was engaged in a Ponzi scheme? They would not and did not.

BACKGROUND AND PROCEDURAL HISTORY

Defendants are the ten individual partners of Sterling Equities ("Sterling"), their family members, trusts, foundations, and affiliated business entities. Each Defendant was a customer of BLMIS. As the world now knows, Madoff, once renowned in the investment community, the former chairman of NASDAQ and vice-chairman of the National Association of Securities Dealers, was engaged in an extraordinary fraud for an extraordinarily long time. For four decades he and a band of criminal colleagues went to extraordinary lengths to deceive thousands of investors, financial institutions, and regulators, including the Securities and Exchange Commission ("SEC"). They also deceived Defendants.

The Trustee's Pre-Complaint Discovery and the Improper Complaint

After Madoff was arrested, his company was put into liquidation under the Securities Investor Protection Act ("SIPA"), and the Trustee was appointed. In October 2009, the Trustee invoked Bankruptcy Rule 2004 and embarked on a vast discovery

campaign concerning Defendants and their relationship with BLMIS. Defendants produced nearly 700,000 pages of documents, and the Trustee took unlimited deposition testimony of the Sterling Partners principally involved with BLMIS. (Seshens Decl. ¶ 3.[1]) The Trustee simultaneously took discovery about Defendants from numerous third parties, including Sterling's banks, other financial institutions, and business partners. (*Id.* ¶¶ 3, 19.)

The Rule 2004 discovery disclosed no evidence that any Defendant was suspicious of Madoff, let alone willfully blind to any Ponzi scheme or other fraud. Nevertheless, the Trustee brought a one billion dollar avoidance action against nearly one hundred named Defendants, replete with allegations that were directly refuted by evidence known to the Trustee at the time. On March 18, 2011, the Trustee filed an amended complaint based on the same unfounded allegations.

Defendants' Motion to Dismiss

In August of 2011, this Court withdrew the bankruptcy reference of this case in its entirety, including Defendants' motion to dismiss or for summary judgment. In their motion papers, Defendants set forth extensive evidence to challenge each material allegation made by the Trustee in his Complaint and other pleadings. Those arguments are incorporated herein by reference.[2]

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[1] References to the "Seshens Decl." are to the Declaration of Dana M. Seshens, dated January 26, 2012 and filed in support of Defendants' Motion for Summary Judgment.

[2] *See* Mot. to Dismiss the Am. Compl. or, in the Alternative, for Summ. J. (doc. no. 20) and papers filed in support thereof (doc. nos. 21 (Mem. of Law); 22 (Rule 56.1 Statement); 23 (Decl. of Dana M. Seshens); 24 (Decl. of Saul B. Katz); 25 (Decl. of Ashok Chachra); 26 (Reply Mem. of Law); and 27 (Supp. Decl. of Dana M. Seshens)).

On September 27, 2011, the Court granted in part Defendants' motion to dismiss and declined to convert the motion to one for summary judgment, on the ground that the Trustee was entitled to some limited additional discovery. The Court held that, "[b]ecause Madoff Securities was a registered stockbrokerage firm, the liabilities of customers like the [D]efendants here are subject to the 'safe harbor' set forth in section 546(e) of the Bankruptcy Code." *Picard v. Katz*, No. 11 Civ. 3605 (JSR), 2011 U.S. Dist. LEXIS 109595, at *9 (S.D.N.Y. Sept. 27, 2011) ("Dismissal Decision"). The Court dismissed all counts of the Complaint except Count One, which seeks avoidance of withdrawals during the two years before BLMIS filed its SIPA petition, and Count Eleven, which seeks equitable subordination of Defendants' claims against BLMIS. The subsequent transfer claims alleged in Count Nine were partially reinstated in a later decision.

The Court further ruled that the Trustee's claims are governed by a "willful blindness" standard. *Id.* at *21-23. Reasoning, in part, that "[a] securities investor has no inherent duty to inquire about his stockbroker, and SIPA creates no such duty," the Court concluded that "good faith" in the context of a SIPA trusteeship must be informed by federal securities law. *Id.* at *21-22. The Court ruled that the Trustee may be able to avoid transfers of "net profits" during the two years prior to bankruptcy "simply by showing that the [D]efendants failed to provide value for those transfers," but that, as to "principal," the Trustee can prevail "only by showing an absence of good faith on [D]efendants' part based on their willful blindness."[3] *Id.* at *23. The same willful

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[3] Defendants submit that they are entitled to summary judgment with respect to all transfers satisfying antecedent debt. Defendants have argued and continue to contend

blindness standard was deemed applicable to the Trustee's claims for equitable subordination. *Id.* at *24-26. The Court reserved decision on the question of how to determine what constitutes principal versus profit during the two-year period. *Id.* at *18 n.6.

The Trustee sought interlocutory appeal of the Dismissal Decision, which was denied on January 17, 2012. *Picard v. Katz*, No. 11 Civ. 3605 (JSR), 2012 U.S. Dist. LEXIS 5143 (S.D.N.Y. Jan. 17, 2012). In its decision, this Court reaffirmed its reasoning as to the application of Section 546(e) and reiterated that "the Trustee could not recover on a theory of negligence, and that the [D]efendants could therefore establish that they had received the transfers from Madoff Securities in 'good faith' under § 548(c) of the Code by showing that they did not know of, or willfully blind themselves to, Madoff Securities' fraud." *Id.* at *7.

Additional Discovery

Following the Dismissal Decision, the Trustee embarked on more expansive, expensive, and burdensome discovery. He served eighty-one new document requests on Defendants and served twenty-one document subpoenas on third parties. (Seshens Decl. ¶¶ 6, 13.) He took twenty more fact depositions. (*Id.* ¶ 15.) The Trustee even sent a private investigator to question acquaintances of Defendants and others. (*Id.* ¶ 17.) This

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that antecedent debt includes all amounts shown on account statements issued by BLMIS, regardless of whether characterized as "principal" or "profit." Defendants recognize, however, that the Court has previously indicated that only the "principal" portion of transfers was "for value," while reserving decision on how to calculate the amount of that portion during the relevant two-year period. Defendants respectfully reserve their position regarding the full amount of the transfers, but submit that the arguments presented herein at the very least entitle them to summary judgment as to all "principal" amounts.

campaign yielded no support for the Trustee's allegations. On the contrary, because the Trustee was required to disclose testimony and other evidence already in his possession, the falsity of his claims has become even more evident.

The Trustee has now had two very large bites at the discovery apple. He has been gathering evidence for over two years. He has an unlimited budget and has spent tens of millions of dollars trying to find support for his baseless allegations. He has *no* evidence that any Defendant was suspicious of Madoff. Instead, discovery has confirmed the truth—Defendants trusted Madoff until the end.

THE FACTS

When they opened their first brokerage accounts with BLMIS, Defendants relied on the recommendations of trusted friends and Madoff's already excellent reputation. Madoff was their broker for more than two decades, during which the Defendants' trust in Madoff was regularly reinforced—by their own interactions with BLMIS, by the regular acceptance of their BLMIS investments by major financial institutions, and by the laudatory views of trusted advisors and friends. BLMIS was registered with the SEC. The Sterling Partners had every reason to believe that Madoff was what he seemed—an extremely successful broker and a luminary in the investment community. Nothing caused them to change that view before December 11, 2008.

A. The Sterling Partners' Early Trust in Madoff Was Well Founded

The story of Sterling Equities began nearly 40 years ago when two brothers-in-law from Brooklyn, Fred Wilpon and Saul Katz, shook hands and began a lasting family partnership. (Defs.' Statement of Undisputed Material Facts Pursuant to Local Rule 56.1(a) ("Rule 56.1") ¶ 1.) They started a small real estate company they called Sterling

Equities. (*Id.*) Sterling grew in the 1980s and 1990s as real estate boomed in New York City. Early on, Fred Wilpon, whose true love has always been baseball, convinced his Partners of the merits of owning a baseball team. (*Id.* ¶ 2.) In 1980, the Sterling Partners acquired an interest in the New York Mets. (*Id.* ¶ 3.)

Over time, the Sterling Partners' business enterprises grew and diversified. (*Id.* ¶ 4.) The Sterling Partners' wealth and their business reputations grew as well. (*Id.* ¶ 5.) As one witness testified, after "30-some years of doing business in New York, Saul and Fred had a reputation for taking care of their partners, being very ethical, being very generous, their philanthropic work, they've earned a reputation for being very quiet and generous in their giving." (Deposition Transcript of Christopher Stamos ("C. Stamos Tr."), Jan. 4, 2012, 50:25-51:8 (Seshens Decl., Ex. A).)

During the same period, Madoff's star was also rising. In 1960, Madoff founded BLMIS and registered it as a broker-dealer with the SEC. (Rule 56.1 ¶ 6.) BLMIS operated three business units: (1) a market making business, (2) a proprietary trading business, and (3) an investment advisory business. (*Id.* ¶ 7.) Madoff was known as a technological innovator, initiating electronic trading at the Cincinnati Stock Exchange. (*Id.* ¶ 8.)

By the mid-1980s, Madoff had become "a prominent and respected member of the investing community, and had served as a member of the NASDAQ stock market's Board of Governors and as the vice-chairman of the National Association of Securities Dealers ('NASD')," *In re Beacon Assocs. Litig.*, 745 F. Supp. 2d 386, 393 (S.D.N.Y. 2010), vice-chairman of the Securities Industry Association and head of its Trading Committee, and chairman of NASDAQ. (Rule 56.1 ¶ 9.) Madoff's star continued to rise,

so much so that in 2003 several prominent Wall Street firms, including Goldman Sachs, Merrill Lynch, and Morgan Stanley, entered into a widely publicized joint venture with Madoff. (*Id.* ¶ 10.)

These two story lines intersected in the 1970s when Fred Wilpon's son, Jeff, and Madoff's son, Mark, became friends in school. (*Id.* ¶ 11.) Ten years later, in 1985, Fred Wilpon and Saul Katz made their first investments with BLMIS. (*Id.* ¶ 12.) They had heard about Madoff's impeccable reputation and strong investment performance from a number of trusted friends, including Howard Squadron, founding partner of the law firm Squadron, Ellenoff, Plesent & Sheinfeld, LLP and president of the American Jewish Congress, and Arthur Levitt, who in 1993 would become Chairman of the SEC. (*Id.* ¶ 13.)

The Sterling Partners also did their own checking. Arthur Friedman, who generally attended to administrative matters for the Partners, tracked transaction prices reflected on BLMIS statements by comparing them against publicly available information in the newspapers to see if they were within the reported price ranges—which they were—and to see if that value was at the high, low, or middle of the range—there was no observed pattern. (*Id.* ¶¶ 14-16.) Mr. Friedman even tried to replicate Madoff's strategy on paper to see if he could generate a profit, which he did. (*Id.* ¶ 17.) Mr. Friedman eventually ceased his work, viewing these exercises as an unequivocal success. (*Id.* ¶ 18.)

Because BLMIS was a registered broker, the Sterling Partners understood it was regulated by the SEC. (*Id.* ¶ 19.) That understanding was confirmed when they heard

that BLMIS had been involved with a situation in which some Florida investors had been sanctioned, but that BLMIS had been cleared. (*Id.* ¶ 20.)

> "There was a time when some Florida investors were sanctioned or something by the SEC. Ike Sorkin was one of the lawyers at Squadron at the time, he was the former—I think he was the former head of the SEC in New York. Something—someone we knew. And I remember being at their offices that day and describing what happened, that the SEC came and—and did an analysis of that particular situation. I don't know how far they went, but that particular situation. And they sanctioned the two people in Florida, and they said that the Madoff operation was perfectly fine." (Deposition Transcript of Fred Wilpon ("F. Wilpon Tr."), Jan. 10, 2012, 143:18-145:1 (Seshens Decl., Ex. I).)

The Partners observed that BLMIS operated as any other brokerage. To open an account, BLMIS required the execution of a customer agreement, an option agreement, and an agreement giving Madoff trading authorization. (Rule 56.1 ¶ 21.) Each customer thereafter regularly received account statements and confirmations that reflected transactions in blue chip stocks ranging from Exxon-Mobil to Coca-Cola when Madoff was "in the market" and U.S. Treasuries when he was not. (*Id.* ¶ 22.) The Partners understood Madoff's strategy to be conservative, intended to limit the effect of market volatility—to "hit singles and doubles" rather than home runs—by "collaring" the trading range of the blue chip securities with puts and calls. (*Id.* ¶¶ 23-24.)

> "We didn't—we wouldn't have done it if we felt risk. We didn't see risk. We were very comfortable with investing money with the Madoff firm. We put more and more money in and [margin loans were] just an opportunity to increase the return on the investment we made. We didn't see, we didn't understand any risk. You could term that, by hindsight you could put a lot of titles on that, but that was a fact. We were not—none of the Sterling partners are people who would generally take risks. (Bankruptcy Rule 2004 Deposition Transcript of Arthur Friedman ("A. Friedman Rule 2004 Tr."), June 22-24, 29, 2010, 484:10-24 (Seshens Decl., Ex. J).)

As the businesses owned by the Partners succeeded and generated more cash, the businesses too opened BLMIS accounts, using them to manage liquidity in much the same manner as traditional bank accounts. (Rule 56.1 ¶ 25.) They deposited cash when it came in, as when the Mets sold season tickets in the fall/winter, and withdrew it when it was needed, such as to pay Mets operating expenses in the spring and summer. (*Id.* ¶ 26.) Part of the appeal of investing with BLMIS was that, unlike hedge fund investments, which could be locked up for months or years, BLMIS was a brokerage and could provide liquidity on demand. (*Id.* ¶¶ 6, 27.) "[I]f you needed money and you couldn't wait until [Madoff] was out of the market, as you used that term, you can always call upon him to liquidate an account. It was a brokerage, after all." (Bankruptcy Rule 2004 Deposition Transcript of Mark Peskin ("M. Peskin Rule 2004 Tr."), July 29, 2010, 181:25-183:2 (Seshens Decl., Ex. P).) That was important to the Sterling Partners given the relatively illiquid nature of many of their assets, such as real estate. (Rule 56.1 ¶ 28.)

B. The Sterling Partners Trusted Madoff as a Broker for Their Family and Close Friends

As Madoff's reputation grew, friends of the Sterling Partners sought access to BLMIS. (*Id.* ¶ 29.) As one witness put it, "people in our community thought Bernie was a God. You know, back then no one would have conceived that Bernie was the guy that he turned out to be. And to get access to Bernie was like gold." (C. Stamos Tr. 118:17-119:3 (Seshens Decl., Ex. A).) The Sterling Partners, deeply loyal to their families, friends, and charities, would never knowingly have put them at risk. (Rule 56.1 ¶ 30.) Believing that Madoff investments were "such a blessing that [they] wanted to share with [their] friends and family" (Bankruptcy Rule 2004 Deposition Transcript of Saul Katz

("S. Katz Rule 2004 Tr."), Aug. 4, 2010, 90:10-17 (Seshens Decl., Ex. N)), they did so, and even helped with the administration of those accounts. (Rule 56.1 ¶¶ 31-32.) No compensation was involved. (*Id.* ¶ 33.) The same motivation led the Partners to offer BLMIS as one of the investment options in Sterling's self-directed 401(k) retirement plan, established in 1997. (*Id.* ¶ 34.)

C. The Sterling Partners Regularly Exposed Their Madoff Holdings to Scrutiny by Major Financial Institutions

The Sterling Partners and related borrowers regularly used their BLMIS holdings as support for their credit agreements, to satisfy liquidity requirements or as collateral. (*Id.* ¶¶ 35-36.) In many cases their monthly statements were sent directly by BLMIS to the lenders for review and confirmation of their holdings. (*Id.* ¶ 37.) BLMIS accounts were readily accepted by the Partners' banks and were considered cash equivalents due to their liquidity. (*Id.* ¶ 38.)

> "[The Banks] were very familiar with Mr. Madoff. They had other clients investing with Mr. Madoff. And they got monthly statements, so they knew what the quality of the collateral was. It was those, you know, the stocks or the Treasuries or the Fidelity account. You know, they were very satisfied. They gave us a dollar-for-dollar loan for every dollar we invested with him." (M. Peskin Rule 2004 Tr. 345:11-25 (Seshens Decl., Ex. P).)

Other institutions were similarly satisfied. For example, in 1990, Travelers Insurance Company undertook due diligence of BLMIS in connection with a financing sought by the Mets. (Rule 56.1 ¶ 39.) A Travelers representative wrote a due diligence memorandum, which was circulated to the Sterling Partners, reporting that he had spoken personally and extensively with Madoff and that he was satisfied with the results of his diligence. (*Id.* ¶¶ 40-41.) The memorandum confirmed the Sterling Partners'

understanding of Madoff's strategy and its ability to weather turbulent markets. (*Id.* ¶ 42.)

> "Madoff has been in the brokerage and money management business for about 30 years. He has been using this technique for about 25 years. During the first 15 years he did not purchase protective puts. However, for the last 10 years he has consistently used puts to protect his down-side. Over the last 10 years the returns have ranged from 12%-25% per year depending on the year. His worst quarter in the last 10 years was the third quarter (October) of 1987, when he lost 1% on the portfolio's value for the quarter." (Travelers Mem., dated Aug. 24, 1990 (Seshens Decl., Ex. R).)

In 1993, J.P. Morgan analyzed one of Saul Katz's BLMIS accounts as part of an exercise to gain more business from Mr. Katz. (Rule 56.1 ¶¶ 43-44.) J.P. Morgan did an "in depth analysis" for one account for 1992 and a more cursory analysis for 1991. (*Id.* ¶ 45.) The only recommendation made was to diversify—with J.P. Morgan. (*Id.* ¶ 46.) No question was raised as to the validity of Madoff, his strategy, or BLMIS. (*Id.* ¶ 47.)

Then, in 2000, a Fitch rating was obtained in connection with the issuance of certain notes collateralized by BLMIS accounts. (*Id.* ¶ 48.) Relying in part on the prior Travelers' analysis, Fitch reported:

> "Fitch IBCA's rating reflects the performance of the Madoff account and takes into consideration the inherent strengths and weaknesses of the Madoff investment strategy. At any given time, Madoff will invest in stocks of the S&P 100, purchase S&P 100 index puts (options to sell at a fixed price) and sell S&P 100 calls (purchaser will have the right to buy at a fixed price). The puts are designed to reduce downside risk and the sale of calls, while limiting upside potential, generates additional cash for the account to be reinvested. The options limit price volatility of the underlying stocks, and allow for the account to capture the dividends being paid by these blue chip companies.
>
> * * *
>
> The partners of Sterling Equities . . . have been investing with Madoff since October 1985 and currently have approximately 250 different accounts managed by Madoff. Sterling's returns on any given year have

never been lower than 16.5% and have averaged in excess of 19%. This time frame has included significant bear markets of the late-1980's and early-1990's." (Letter from Robert J. Grossman to Marvin B. Tepper, (May 25, 2000) at 2 (Seshens Decl., Ex. T), *see also* Rule 56.1 ¶ 49.)

Fitch reaffirmed its rating early in 2003, stating that the "affirmation reflects the consistent level of returns generated by the Account which collateralizes the Notes." (Letter from Sharon Bonelli to Arthur Friedman (Jan. 2, 2003) at 1 (Seshens Decl., Ex. U); *see also* Rule 56.1 ¶ 50.)

D. Defendants Diversified, But Still Entrusted Hundreds of Millions of Dollars to Madoff

As the Sterling Partners' businesses prospered, they generated more and more liquidity. (Rule 56.1 ¶ 51.) As deposits into their BLMIS accounts grew, Saul Katz's son, David, continued to impress upon his father and the rest of the Sterling Partners that they should diversify their liquid investments—not because he was concerned about Madoff, but because he thought it was unwise to have so much money in one place. (*Id.* ¶¶ 52-53.)

Diversification became a higher priority for the Sterling Partners after Fred Wilpon and Saul Katz had a discussion with Madoff about what would happen to their accounts when he retired. (*Id.* ¶ 54.) Madoff was in his 60s, about their age, and they inquired about his succession plan. (*Id.* ¶ 55.) Madoff told them that his business would not survive his retirement because his sons ran, and wanted to continue to run, a different part of the business, and no one else was poised to take over. (*Id.* ¶ 56.) Instead, he indicated that he would liquidate their investments and send them a check that they could deposit with U.S. Trust. (*Id.* ¶ 57.) That was not a desirable option, so the Sterling

Partners determined they wanted a better alternative to preserve their families' wealth for the future. (*Id.* ¶ 58.)

Out of this confluence of factors, Sterling Stamos Partners ("Sterling Stamos") was born in the summer of 2002. (*Id.* ¶ 59.) Saul Katz had met Peter Stamos, a brilliant economist and Rhodes Scholar, through his charitable work for the North Shore/Long Island Jewish Hospital System, and thought he would be ideal to run an alternative investment vehicle for the Katz and Wilpon families. (*Id.* ¶¶ 60-62.) The enterprise, a fund of funds, was launched, and the Sterling Partners began to deposit some of their excess liquidity into the funds run by Sterling Stamos. (*Id.* ¶ 63.) However, they continued to entrust hundreds of millions of dollars to Madoff and BLMIS. (*Id.* ¶ 64.)

Peter Stamos' view of Madoff formed another part of the foundation for the Sterling Partners' trust. Peter Stamos, who, along with his family, also had been a BLMIS investor, told Saul Katz he thought Madoff was an honest and extraordinary broker. (*Id.* ¶¶ 65-66.)

> "I'm embarrassed to say that I said to Mr. Katz on a number of occasions that my assumption is that Mr. Madoff is the most honest and honorable man, among the most honest and honorable men that we will ever meet. Number one. And, number two, that he is perhaps one of the—my assumption is he's perhaps one of the best hedge fund managers in modern times. . . .
>
> [The first assumption was b]ased on his reputation, based upon his long track record, based upon having seen him receive these awards and the positions that he held as chairman of the NASDAQ, having built this great company. He was, quite frankly, legendary, to all of us. And I stood in awe of that with Mr. Katz, and I assumed that." (Bankruptcy Rule 2004 Deposition Transcript of Peter Stamos ("P. Stamos Rule 2004 Tr."), Aug. 19, 2010, 211:13-212:4 (Seshens Decl., Ex. W).)

This was so even though Sterling Stamos, as a fiduciary, had decided not to invest third-party funds with any manager who employed a proprietary or "non-transparent"

strategy, a policy which precluded investment in many successful investment managers, including BLMIS. (Rule 56.1 ¶¶ 67-68.) As Mr. Stamos explained, "as a fiduciary I could not put my capital, my fund's capital there, [but] I agreed with [Saul Katz]. Legend in the industry and all of the things that he said." (P. Stamos Rule 2004 Tr. 162:1-162:7 (Seshens Decl., Ex. W).)

> "[I]n that pantheon, I would include people like Seth Klarman of Baupost, who I've mentioned several times, who also would not make it through our due diligence process because of the level of opaqueness in his portfolio. But, you know, Bernard Madoff was held by me and by virtually everyone else I know in the industry in that pantheon of top ten, let's call it." (Deposition Transcript of Peter Stamos ("P. Stamos Tr."), Jan. 5, 2012, 279:14-280:1 (Seshens Decl., Ex. B).)

And Peter Stamos, who was competing with Madoff for the Sterling Partners' money, would have been happy to tell them that he had concerns about Madoff. (Rule 56.1 ¶¶ 69-70.) But he had none. (*Id.* ¶ 71.)

> "[W]hat I have conviction on is that if I had any inkling of there being a problem there [with Madoff], I would have gone immediately to Mr. Katz for two reasons, [one], as a fiduciary to him, I'd be worried.
>
> Number 2 is I was in competition with Mr. Madoff, and I would have loved to have had several hundred million dollars of assets from the Katz and Wilpon family with me. What I have deep conviction around is that I had no understanding that there were issues there." (P. Stamos Tr. 103:20-104:19 (Seshens Decl., Ex. B).)
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> * * *
>
> "In addition, it would be an incredible boon for us if that were the case, because then I could have all that capital come and invested with me, and I'd been trying for years to get [the Sterling Partners] to move 90 percent of their assets to me and to keep 10 percent with Bernie Madoff as a side account for their personal investments. So at no time did I have any inkling of that." (*Id.* 301:20-302:18.)

E. The Sterling Partners Trusted Madoff Until the End

No one felt more betrayed than Fred Wilpon when Madoff's fraud was revealed on December 11, 2008—it was like a "dagger in the heart." (Rule 56.1 ¶ 72.) That very day, before Madoff's arrest was made public, a $1 million deposit was made into a Sterling-related Madoff account. (*Id.* ¶ 73.) Mr. Wilpon, Mr. Katz, their Partners, children and grandchildren, family trusts, charitable foundations, and businesses, including the New York Mets, lost in the aggregate more than $500 million that day. (*Id.* ¶ 74.)

SUMMARY JUDGMENT STANDARD AND BURDEN OF PROOF

Summary judgment is warranted where, as here, "there is no *genuine* dispute as to any material fact." Fed. R. Civ. P. 56(a) (emphasis added). Defendants are entitled to summary judgment if they demonstrate a lack of evidentiary support for the Trustee's claims and the Trustee "fails to make a showing sufficient to establish the existence of an element essential to [his] case." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23, 325 (1986). To make the requisite showing, the Trustee must "do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). He must come forward with "'specific facts showing that there is a genuine issue for trial,'" *id.* at 587, and "persuasive evidence that his claim is not 'implausible,'" *Brady v. Colchester*, 863 F.2d 205, 211 (2d Cir. 1988) (citing *Matsushita*, 475 U.S. at 587). This the Trustee cannot do.

As claim proponent, the Trustee bears the burden of establishing the elements of a fraudulent conveyance claim under Section 548(a)(1)(A). Therefore, Defendants submit, the Trustee must demonstrate that the transfers were not made to valid creditors and did

not discharge valid antecedent debt because, at the time Defendants invested, they had knowledge of or were willfully blind to BLMIS' fraud. *See* New York Uniform Commercial Code ("NYUCC") § 8-502 (setting out circumstances under which no valid securities entitlement is created between a broker and its customer); *see also id.* § 8-105(a)(1), (2). That is the teaching of now-Justice Breyer's decision in *Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1509 (1st Cir. 1987), on which the Second Circuit relied in *In re Sharp International Corp.*, 403 F.3d 43 (2d Cir. 2005).

In *Boston Trading*, then-Judge Breyer engaged in a thorough analysis of the history and principles underlying fraudulent conveyance law, focusing on the difference between a transfer that is fraudulent, which would not include a payment made to a creditor to discharge antecedent debt, and one that is preferential, which would. 835 F.2d at 1508-09. As Judge Breyer explained, a payment on antecedent debt cannot be challenged as fraudulent, regardless of where the funds came from or what the transferee knew at the time of the transfer, because that would not serve the purpose of fraudulent conveyance law. *Id.* at 1511.

> "[T]o find an actual intent to defraud creditors when, as in our example, an insolvent debtor prefers a less worthy creditor, would tend to deflect fraudulent conveyance law from one of its basic functions (to see that an insolvent debtor's limited funds are used to pay *some* worthy creditor), while providing it with a new function (determining *which* creditor is the more worthy)." *Id.* (emphasis in original).

Here, the Trustee cannot meet his burden of proving the existence of a fraudulent conveyance claim under Section 548(a)(1)(A) unless he can establish that BLMIS' obligation to a Defendant was invalid at the time it was created because, at that time, the Defendant had knowledge of, or was willfully blind to, Madoff's fraud. The Complaint

does not even challenge the validity of the obligations that were discharged by the transfers the Trustee seeks to avoid, and the Trustee does not dispute that Defendants were BLMIS creditors when they withdrew funds from their brokerage accounts. Accordingly, because the Trustee cannot meet his burden of proving the existence of a fraudulent transfer under Section 548(a)(1)(A), the affirmative defense under 11 U.S.C. § 548(c) need never be reached. In any event, Defendants have demonstrated that no Defendant was willfully blind and, therefore, are entitled to summary judgment irrespective of which party bears the burden with respect to willful blindness.

ARGUMENT

There is no evidence that any Defendant was willfully blind to Madoff's Ponzi scheme. To the contrary, the evidentiary record establishes, without question, that Defendants trusted Madoff until the day his fraud was disclosed. To rebut the proof offered by Defendants that none was willfully blind, at the time any Defendant deposited *or* withdrew funds from BLMIS, the Trustee would have to present evidence of both guilty knowledge and evasive action in accord with the definition of willful blindness recently set forth by the Supreme Court: "(1) the defendant must *subjectively* believe that there is a *high probability* that a *fact* exists and (2) the defendant must take *deliberate actions* to avoid learning of that fact." *Global-Tech Appliances, Inc. v. SEB, S.A.*, 131 S. Ct. 2060, 2070 (2011) (emphasis added).

> "[T]hese requirements give willful blindness an appropriately limited scope that *surpasses recklessness and negligence.* Under this formulation, a willfully blind defendant is one who takes *deliberate* actions to avoid confirming a *high probability of wrongdoing* and who can *almost be said to have actually known* the critical facts. By contrast, a reckless defendant is one who merely knows of a substantial and unjustified risk of such wrongdoing, and a negligent defendant is one who should have known of

> a similar risk but, in fact, did not." *Id.* at 2070-71 (emphasis added) (citations omitted).

The Second Circuit has deemed willful blindness "tantamount to knowledge." *Tiffany Inc. v. eBay, Inc.*, 600 F.3d 93, 110 n.15 (2d Cir. 2010) (collecting cases). Article 8 of the NYUCC, which governs transactions with BLMIS as a financial intermediary in the indirect holding system, has codified the same "willful blindness" standard. Under Article 8, a person seeking to invalidate a securities entitlement must prove that the entitlement holder "is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists," which turns "on the actor's state of mind," and has "'deliberately avoid[ed] information' that would establish the existence of the adverse claim." NYUCC § 8-105(a)(2) & cmt. 4.

I. THERE IS NO EVIDENCE THAT ANY DEFENDANT WAS WILLFULLY BLIND

The Trustee's now massive evidentiary record demonstrates without question that the Sterling Partners trusted Madoff throughout their nearly twenty-five year relationship with him. No Sterling Partner ever suspected that Madoff was engaged in any kind of fraudulent conduct. (Rule 56.1 ¶ 75.) Not only has each Partner attested to that belief, but their actions prove it. They invested hundreds of millions of hard-earned dollars with Madoff and put the stability and financial future of their families in his hands. They deposited with BLMIS revenues generated by the businesses they had worked years to build, giving him discretion to manage some of the businesses' excess liquidity. They regularly opened their BLMIS holdings to scrutiny by major financial institutions—an action entirely inconsistent with a suspicion that BLMIS was a Ponzi scheme. And they

helped their closest friends and family members, and even their employees, to get access to BLMIS accounts because they wanted to share what they viewed then as a blessing.

The Sterling Partners had a concrete foundation for their trust in Madoff. Madoff was a luminary in the investment community—the chairman of NASDAQ and vice-chairman of the NASD. BLMIS had been registered with the SEC for decades and had performed brokerage services impeccably throughout. Large banks and other institutions regularly reviewed and accepted BLMIS accounts as security. Close friends and trusted advisors repeatedly confirmed that Madoff was honorable and brilliant.

We now know that, like thousands of other Madoff investors, the Sterling Partners were grievously deceived. As many courts have observed, Madoff leveraged his standing in the community to perpetrate an almost unthinkable fraud. *See, e.g.*, *In re Merkin & BDO Seidman Sec. Litig.*, No. 08 Civ. 10922, 2011 U.S. Dist. LEXIS 112931, at *26 (S.D.N.Y. Sept. 23, 2011) ("[I]t is now well-established that Madoff cleverly leveraged his considerable reputation in order to perpetrate his massive fraud, for many years, without detection by some of the most sophisticated entities in the financial world: the SEC, Wall Street banks, and the like."); *Saltz v. First Frontier, LP*, 782 F. Supp. 2d 61, 67 n.1 (S.D.N.Y. 2010) (Madoff was a "a prominent and respected member of the investing community . . . [who] deceived countless investors and professionals, as well as his primary regulators, the Securities and Exchange Commission ('SEC') and the Financial Industry Regulatory Authority ('FINRA')"); *Wolf Living Trust v. FM Multi-Strategy Inv. Fund, LP*, No. 09 Civ. 1540, 2010 U.S. Dist. LEXIS 118169, at *3 (S.D.N.Y. Nov. 2, 2010) (same); *Newman v. Family Mgmt. Corp.*, 748 F. Supp. 2d 299, 303 (S.D.N.Y. 2010) ("Madoff was a prominent and respected member of the investing

community, whose investment company, BMIS, had operated since approximately 1960."); *SEC v. Cohmad Sec. Corp.*, No. 09 Civ. 5680, 2010 U.S. Dist. LEXIS 8597, at *6-7, 14-15 (S.D.N.Y. Feb. 1, 2010) ("Madoff's established reputation as a successful and respected investment adviser" and his "use of elaborate machinery . . . fooled . . . individual investors, financial institutions, and regulators.").

Against this backdrop, the Trustee contends that *these* Defendants decided to risk the financial stability of their families, their friends, and their successful businesses by investing in what they suspected was a Ponzi scheme—all for incremental returns that were dwarfed by the success of their own businesses. The accusation is nonsensical, and the Trustee lacks any modicum of proof.

A. No Defendant Subjectively Believed That There Was Any Probability That Madoff Was Running a Ponzi Scheme or Engaged in Fraud

The record conclusively establishes that every Sterling Partner trusted Madoff and never had any suspicion that he was running a fraudulent enterprise. Because there is no evidence to the contrary, the Trustee cannot raise a triable issue of fact and summary judgment is warranted.

1. The Sterling Partners Never Sought Insurance Because of Concerns About a Madoff Fraud or Ponzi Scheme

The Trustee has claimed that the Sterling Partners must have suspected Madoff was engaged in a Ponzi scheme because they went on a "shopping spree" for Ponzi scheme insurance in 2001. The claim is illogical. Why would a group of astute businessmen with honorable reputations invest hundreds of millions in a Ponzi scheme, expose what they were doing to numerous major financial institutions, and then try to mitigate the risk of devastating loss through fraud insurance which they did not even

buy? Of course, as the evidence demonstrates, they did no such thing. There never was any "shopping spree."

What did happen is that a trusted business partner, Chuck Klein, purchased a third-party fidelity policy for all of the securities investments his company made on behalf of its clients and suggested to the Sterling Partners that they consider doing the same. (Rule 56.1 ¶¶ 76-78, 82.) Because the Partners respected Mr. Klein and his business judgment, Sterling Partner Arthur Friedman met with Mr. Klein's insurance broker. (*Id.* ¶¶ 79-80) The Sterling Partners concluded shortly thereafter that the insurance was unnecessary and expensive. (*Id.* ¶ 81.) As Saul Katz put it, "[w]e weren't going to buy insurance on something that we thought was as good as gold and waste money." (S. Katz Rule 2004 Tr. 100:17-101:21 (Seshens Decl., Ex. N).)

Although not disclosed to Defendants until recently, Mr. Klein was deposed by the Trustee as part of Rule 2004 discovery. (Seshens Decl. ¶ 21.) His testimony confirms that his suggestion to the Sterling Partners was not motivated by any concern about Madoff. Rather, he purchased the insurance for all of his firm's third-party investments—with firms such as Bear Stearns and Credit Suisse, as well as Madoff—because he thought it was "the cheapest put" he had ever seen. (Rule 56.1 ¶¶ 82-83.)

Defendants also now know that as part of his Rule 2004 discovery the Trustee interviewed the insurance broker with whom Arthur Friedman met. (Seshens Decl. ¶ 22.) Defendants have no access to the interview notes, but given that the Trustee elected not to depose the broker, one may conclude that the broker's testimony would not dispute that of Mr. Friedman, who explained that notes taken by him at the meeting reflected what the

broker explained *to him* about the scope of the insurance coverage, including coverage of a "Ponzie" scheme. (Rule 56.1 ¶¶ 84-85.)

2. Nothing About Sterling Stamos Undercut the Sterling Partners' Trust in Madoff

The majority of the Trustee's "willful blindness" allegations concern Sterling Stamos in some way. Many are false, while others are unsubstantiated or irrelevant or both. None demonstrates that any Sterling Partner believed Madoff was engaged in any kind of fraud.

First, even though the evidence demonstrates without contradiction that Sterling Stamos was started to diversify the Sterling Partners' liquid investments, for which Madoff had no succession plan (*Id.* ¶¶ 52-59, 62-63, 86.), the Trustee insists that the real reason was concern that Madoff might be engaged in fraud. No evidence supports such speculation, which makes no sense given that Defendants left, in the aggregate, half a billion dollars with Madoff even after Sterling Stamos was created. If the Sterling Partners were worried about a possible Madoff Ponzi scheme, they would have taken *all* of their money out and moved it over to Sterling Stamos. But they did not.

Second, the Trustee has argued that Peter Stamos repeatedly warned the Sterling Partners that Madoff was a fraud and not to invest with him at all. Those allegations are demonstrably false. (Mem. of Law in Supp. of Mot. to Dismiss (doc. no. 21) at 6-11; Reply Mem. of Law (doc. no. 26) at 12-16.) And testimony recently elicited by the Trustee from one of Peter Stamos' former employees, Noreen Harrington, who says she did raise questions about Madoff, is suspect and entirely unsubstantiated. But even taken as true, the testimony proves that Saul Katz was the opposite of willfully blind.

Ms. Harrington says that she reported, at a meeting attended by Saul Katz, Peter Stamos, and others, on an earlier meeting she had with Ezra Merkin, then a well respected fund manager with whom Sterling Stamos was considering a further investment. (Deposition Transcript of Noreen Harrington ("N. Harrington Tr."), Dec. 30, 2011, 111:15-112:8; 184:6-12 (Seshens Decl., Ex. AA).) She and her colleague, Ashok Chachra, had visited Mr. Merkin for due diligence purposes. (*Id.* 66:15-67:17.) According to Ms. Harrington, Mr. Merkin treated her poorly and rejected her requests for information, but for some reason disclosed to her what he allegedly kept from his clients—that certain of his funds were feeders to Madoff. (*Id.* 68:5-20; 69:6-72:10; *see also In re Merkin*, 2011 U.S. Dist. LEXIS 112931, at *5.) That concerned her, so following her meeting with Merkin she "thought a lot about the math." (N. Harrington Tr. 203:21-204:16; 206:3-16; 216:2-19 (Seshens Decl., Ex. AA).) At the meeting with Messrs. Stamos, Katz and others, she says she complained about Merkin and then speculated as follows about Madoff:

> "So, anyway, Saul Katz wasn't happy with me and he actually asked me a question. He asked me what I—it was fairly linked to what I said before, which was about me having, you know, all the answers. And I said to him, you know, quite to the contrary, I don't have enough answers and, you know, that's part of the problem. But he said, well, what do you think Madoff does with the money? He asked me specifically for my own opinion. And I gave it. And my answer was this, which is, I made an accusation of front-running, which is profitable and non-correlated, but also illegal. And I said, if it wasn't that, I believed it was fiction. And to that he said, what do you mean by fiction? And I said, I don't believe the numbers are worth the paper they're written on." (*Id.* 116:20-117:19.)

When asked at her deposition how she reached that conclusion, Ms. Harrington did not know. (*Id.* 118:1-9.) She testified that she did not "have the hard tangible facts to be able to say that [she] was right or wrong" about Madoff. (*Id.* 218:24-219:25

(objection of counsel withdrawn).) According to Ms. Harrington, when pressed by Mr. Katz at the meeting, she was equivocal, telling him "I have been wrong before, I could be wrong now." (*Id.* 119:13-120:6.) She was unequivocal, however, that neither Peter Stamos nor Saul Katz believed her.[4] (*Id.* 121:14-18; 245:5-246:20.)

Ms. Harrington's recollection is supported by no other evidence. Mr. Katz does not recall the meeting. (Deposition Transcript of Saul Katz ("S. Katz Tr."), Jan. 13, 2012, 195:19-197:6 (Seshens Decl., Ex. L).) Peter Stamos and Ashok Chachra remember the meeting, but do not remember any concerns being raised about Madoff. (P. Stamos Tr. 166:14-171:8 (Seshens Decl., Ex. B); Bankruptcy Rule 2004 Deposition Transcript of Ashok Chachra ("A. Chachra Rule 2004 Tr."), Oct. 8, 2010, 29:6-40:4 (Seshens Decl., Ex. Y).) But there is no need to determine whether the meeting happened or what, in fact, was said. Ms. Harrington's testimony is that, far from consciously turning away from her accusation, Mr. Katz questioned her about it. She says that neither he nor Mr. Stamos believed her unsubstantiated hunch, which would not be surprising given everything else Mr. Stamos and Saul Katz knew about Madoff. *See In re Merkin*, 2011 U.S. Dist. LEXIS 112931, at *33 (finding "no basis for imputing scienter just because a

[4] Ironically, in 2003, while at Sterling Stamos, Ms. Harrington was a whistleblower about another situation related to her prior employer, with respect to which she had gone to the authorities with "factual, tangible, physical evidence that a crime was taking place." (N. Harrington Tr. 261:14-262:5; 274:5-275:4 (Seshens Decl., Ex. AA).) But she never reported her suspicion of Madoff, or discussed it with anyone thereafter, because she had nothing to support her opinion. (*Id.* 266:21-267:11; 274:5-275:4; 276:11-16.) As she stated, in her mind the two situations were "incredibly different" and "light years apart." (*Id.* 274:5-275:4.) Indeed, Ms. Harrington never did anything to follow up on her views about Madoff (*id.* 276:11-16)—but not because anyone stopped her. Though she claims to have asked to meet with Madoff, she quit almost immediately after this meeting and testified that there was no time for her to do anything further. (*Id.* 248:7-249:10; 250:7-18.)

non-party had a hunch or a gut feeling about Madoff, especially when juxtaposed against his considerable reputation and success within the investment community"). Thus, Ms. Harrington's testimony is further evidence of Mr. Katz's state of mind: he trusted Madoff and Peter Stamos, and did not believe Ms. Harrington's speculation.

Third, the Trustee contends that the Sterling Partners gained investment management expertise through their association with Sterling Stamos, which should somehow have enabled them to figure out Madoff's fraud—even though Peter Stamos himself did not. For example, the Trustee claims that because *Sterling Stamos* invested in a fund called "Bayou," which turned out to be a Ponzi scheme, the *Sterling Partners* must have known that Madoff was a Ponzi scheme as well. But the two investments were not comparable, and no one at *Sterling Stamos* ever made any connection between the Bayou fraud and BLMIS. Why then should the *Sterling Partners* have done so? The evidence is clear that they never did.

Finally, the Trustee makes the confused argument that the Sterling Partners caused Sterling Stamos to restructure in connection with its registration as an investment advisor because of concerns raised by Madoff. But the evidence shows that the Sterling Partners were only concerned that one or more of them might have to register as well, causing disclosure of *all* of the *Sterling Partners'* otherwise private investment and business holdings, including with BLMIS. (Rule 56.1 ¶ 87.) The Sterling Partners were also concerned that, through Sterling Stamos' registration, their ownership interest might give rise to an increased risk of third-party liability for Peter Stamos' investment decisions, with which they were not involved. (*Id.* ¶¶ 88-89.) Neither issue has anything to do with protecting Madoff or BLMIS from disclosure or otherwise.

3. The Sterling Partners Understood That Madoff's Returns Were Intended to Be Consistent and Were Not Concerned When They Were

The Trustee claims that Madoff's consistent returns were "too good to be true" and should have given rise to a fraud suspicion. Neither the Sterling Partners nor the thousands of other Madoff investors were suspicious of his consistent returns. The Sterling Partners expected that Madoff's strategy, which was intended to yield consistent returns, would do so. (*Id.* ¶ 90.) They were satisfied, not suspicious, when it did. (*Id.* ¶ 91.) Peter Stamos told them that consistency is something to look for in an investment manager (*Id.* ¶ 92), not that it is an indication of fraud. And, in 2003, Fitch reaffirmed its bond rating on the basis of Madoff's consistent returns. (*Id.* ¶ 50.)

Furthermore, courts have held as a matter of law that Madoff's investment success and consistency are not signs of fraud. *See, e.g.*, *Stephenson v. PricewaterhouseCoopers LLP*, 768 F. Supp. 2d 562, 577 (S.D.N.Y. 2011) (refusing to hold that "success in securities trading is a red flag," even for auditors with particular hedge fund and investment vehicle expertise) (quoting *Stephenson v. Citco Grp. Ltd.*, 700 F. Supp. 2d 599, 624 (S.D.N.Y. 2010)); *Saltz*, 782 F. Supp. 2d at 68, 71, 76 (rejecting the allegation that the consistency of Madoff's investment returns, among other things, was a sufficient basis to infer that BLMIS feeder fund and fund's auditor had knowledge of Madoff's fraud).

4. The Sterling Partners Thought Proprietary Strategies Entirely Appropriate and Were Not Concerned About Madoff's "Black Box"

The Trustee also contends that Madoff's refusal to disclose everything about his strategy should also have been taken as a badge of fraud. It was not. Because BLMIS provided brokerage statements every month, Madoff's strategy was far more transparent than that of a hedge fund, but the Sterling Partners thought proprietary, or "black box," investment strategies were common and had no concern about the proprietary nature of part of Madoff's strategy. (Rule 56.1 ¶¶ 93-94.)

> "[Madoff] was a—he was a proprietary investor, didn't want people to understand what his—how he came to his investments, and therefore that wouldn't be transparent. For example, one of the great investors of the past 40 years is Renaissance, Mr. Simons and his group. They're not transparent. It's proprietary investing, and if you choose to invest with him, if you're fortunate to do that, you don't know what he's investing in or how he's investing or how he's determining those investments."
> (F. Wilpon Tr. 66:4-17 (Seshens Decl., Ex. I).)

Nor did anyone ever suggest that proprietary strategies were suspicious or a sign of fraud. To the contrary, the Sterling Partners knew that Sterling Stamos would not, as a fiduciary, invest third-party funds with Madoff because he employed a proprietary strategy and, therefore, lacked the requisite transparency, yet Peter Stamos told them Madoff was an "honest and honorable" man until the day his fraud was disclosed. (Rule 56.1 ¶¶ 67-68, 95.) The two concepts are not related.

5. Madoff Deceived Many with His Highly Organized Fraud

Finally, it is apparent that one of the many reasons that so many people were fooled by Madoff is that his fraud was meticulously executed. Bruce G. Dubinsky, the Trustee's expert, an experienced fraud investigator and forensic accountant, has issued a

lengthy report documenting the remarkable efforts Madoff and his criminal colleagues undertook to keep the fraud machine going for so long. (*See generally*, Expert Report of Bruce G. Dubinsky ("Dubinsky Rep.") (Seshens Decl., Ex. C).) Indeed, to unravel the scheme—even after having the head start provided by confessions of key players—Mr. Dubinsky and his team, with another expert, spent more than $16 million (excluding the additional cost of the forensic consultants on whose work Mr. Dubinsky and his team relied), demonstrating the lengths to which Madoff went to conceal his fraud and the unlikelihood that his victims could have discerned it.

The Dubinsky Report details how computer systems were devised to permit Madoff and his colleagues to create over 29 million false documents, including fake regulatory filings and fake customer records, and how regular confirmations and account statements were generated for thousands of customers over several decades. (*Id.* ¶¶ 23, 25, 193-227.) Actual market information was used to give customer records authenticity. (*Id.* ¶¶ 56, 193-204.) Indeed, Mr. Dubinsky even demonstrated how Madoff falsified electronic DTC trading records and a fake DTC computer screen. (*Id.* ¶¶ 138-52.)

Madoff used real information and reports throughout to give authenticity to his fake enterprise. Mr. Dubinsky reports that the market making and proprietary trading arm of BLMIS "operated as a securities broker-dealer registered with the U.S. Securities and Exchange Commission in the United States;" that its "customers included securities firms and banks;" and that it "was a market maker in S&P 500 stocks, US convertible bonds, preferred stocks, warrants, units, and rights." (*Id.*, App'x. C at 14.) In addition, BLMIS "acted as a proprietary trader on its own account." (*Id.*) Masterfully, BLMIS used these legitimate operations to cause its fake operation to appear equally legitimate:

> "If I'm already selling cars, I'm already in the business. If I want to now start a fraud selling cars that I bought on the black market and throw them into my lot, makes it easy to do, doesn't it? So when you have that kind of opportunity—it's much harder if I want to go out and put a storefront up to sell cars and I've never done it before. . . . [W]hen you have that kind of opportunity and you have the inside track on how to run a business already, how to do it, you can make things happen." (Deposition Transcript of Bruce Dubinsky ("Dubinsky Tr."), Jan. 11, 2012, 84:13-85:6 (Seshens Decl., Ex. D).)
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> * * *
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> "[T]he analogy to the car dealer, you've got somebody over here trading stocks and bonds and acting as a market maker, they have the prop trading. That makes it easier to facilitate pulling something like this off, in my opinion." (*Id.* 85:7-23.)

B. There Is No Evidence That Any Defendant Took Deliberate Action to Avoid Learning the Truth About Madoff's Ponzi Scheme

For any Defendant to be willfully blind, the Trustee must demonstrate not only that a Defendant believed there was a high probability that Madoff was running a Ponzi scheme, but also that such Defendant deliberately turned away from information that would have confirmed it. No Defendant did. (Rule 56.1 ¶ 96.)

For example, in *Global-Tech*, the defendant copied an overseas version of an innovative fryer, knowing that it would not bear a U.S. patent marking, to sell the product in the States. 131 S. Ct. at 1172. The defendant then sought a "right-to-use" patent opinion for the fryer, but did not disclose to counsel that the product was a copy. *Id.* Upon being sued for patent infringement, the defendant denied knowledge of the patent. *Id.* at 1173. Concluding that the defendant deliberately withheld relevant information from its attorney so that it could "manufacture a claim of plausible deniability," the Court found that the defendant was willfully blind. *Id.* at 1180. Similarly, in the only case addressing "willful blindness" under UCC § 8-105, the Second Circuit considered

whether a bank employee was willfully blind to an adverse claims made against certain securities held by the bank in a margin account. *SEC v. Credit Bancorp Ltd.*, 386 F.3d 428, 450-53 (2d Cir. 2004). The Court found that, where an experienced banker received and read press releases alleging an adverse claim against certain securities and then asked third parties about the circumstances surrounding the bank's possession of those securities, his deliberate failure to examine documents in his possession that would have confirmed the press releases' allegations constituted willful blindness. *Id.* at 452-53.

By contrast, the Trustee has never identified *any* information that *any* Defendant actually refused to contemplate because it might have confirmed Madoff's fraud. Instead, the Trustee appears to be claiming that Defendants "blinded" themselves through a failure to do due diligence. The Trustee's "red flags expert" has put forth a series of "red flags"—some alleged in the Complaint, others not—that, in the opinion of the expert, should have caused further diligence under the customs and practices of institutional investors in the investment management industry. (*See* Mem. of Law in Supp. of Mot. to Strike at 2-4.[5])

This Court has already ruled that "a securities investor has no inherent duty to inquire about his stockbroker, and SIPA creates no such duty." *Katz*, 2011 U.S. Dist. LEXIS 109595, at *22. And there is no evidence that any Defendant was aware of all, or even a number, of these "red flags." Each Defendant was investing only his own funds; none was paid to invest for others. None of the Defendants is an institutional investor in

[5] References to the "Mem. of Law in Supp. of Mot. to Strike" are to the Memorandum of Law in Support of Defendants' Motion to Strike the Expert Reports and Testimony of Steve Pomerantz and Harrison J. Goldin, filed with the Court on January 26, 2012.

any event, so evidence of institutional investor custom and practice is irrelevant. (Mem. of Law in Supp. of Mot. to Strike at 7-10.) Similarly irrelevant is the opinion of the Trustee's "retirement plan industry standards" expert, as no claim in this case is based on breach of any such standard and the Trustee would have no standing to assert such a claim in any event. (*Id.* at 5, 10-11.)

II. WILLFUL BLINDNESS MUST BE PROVEN AS TO EACH DEFENDANT AND CANNOT BE IMPUTED COLLECTIVELY

The Defendants who remain in the case following the Court's prior rulings comprise a wide variety of people and entities, including partners in various Sterling-related business entities; the entities themselves, who have separate legal existences; spouses; adult children; minor children; and family trusts and foundations. These Defendants are those who (a) allegedly received an initial transfer from BLMIS during the relevant two-year period preceding BLMIS' SIPA filing (Count One), or (b) filed a claim against the BLMIS estate that the Trustee is seeking to equitably subordinate (Count Eleven), or (c) allegedly received a subsequent transfer from an account that received an alleged initial transfer during the relevant two-year period (Count Nine).[6]

The Court has ruled that the transfers these Defendants received can be avoided or subordinated only if the relevant Defendant was willfully blind. *Katz*, 2011 U.S. Dist. LEXIS 109595, at *23-25. The Trustee does not claim that the vast majority of these Defendants were themselves willfully blind—instead he resorts to radical extensions of agency and veil-piercing theories as a basis for imputing willful blindness to them. (*See* Compl. ¶¶ 1080-1101.) There is no evidence to support such theories, and there is no

[6] Those Defendants subject to Count One and Count Eleven are set forth in Appendices A and B, attached hereto, respectively.

basis here to impute willful blindness from one Defendant to another or to dozens of others as a group. Consequently, even if the Trustee could raise a triable issue of fact that one or more of the Defendants was himself actually willfully blind when investing at BLMIS, which he cannot, all other Defendants are entitled to summary judgment as a matter of law.

To make an alter-ego or veil-piercing argument, the Trustee must prove (1) that a party, presumably the Sterling Equities partnership or one or more of its Partners, "exercised complete domination" over the other parties sought to be charged with respect to the transactions at issue and (2) that "such domination was used to commit a fraud or wrong that injured" BLMIS, "the party seeking to pierce the veil." *Am. Fuel Corp. v. Utah Energy Dev. Co.*, 122 F.3d 130, 134 (2d Cir. 1997). There is no evidence to support either prong of the test.

The Trustee's main contention is that the "intent" of the Sterling Equities partnership is imputable to all Defendants because the partnership made or coordinated the investment decisions for all other Defendants. There is, however, no evidence that the Sterling Equities' *partnership*—which does not own any of the relevant assets—made *any* investment decisions for anyone. (Rule 56.1 ¶¶ 97-98.) There is certainly no indication that the partnership dictated transfers to, and investments by, children or charities or others. Rather, the record is replete with evidence that when distributions generated by a particular business transaction were made to individual partners, each

made his own decision about investing—or not investing—*his* excess cash.[7] (Rule 56.1 ¶ 98.)

Moreover, there is no support in the law for the proposition that a partnership can have an "intent" or any other state of mind separate and apart from those of its individual partners. Even if one of the Partners was willfully blind when investing in BLMIS, which none of them was, his state of mind would negate the formation of a valid antecedent debt (or securities entitlement) only as to those investments for which he had authority, and not for the separate investments of his Partners, much less his Partners' spouses, children, or other individual account holders.

In the same vein, through his "red flags" expert, the Trustee suggests that all of the Defendants may be treated as a single entity, "the Sterling," because the Sterling Equities partnership can be deemed to have *controlled* all of their investments through Sterling Partner Arthur Friedman's role as an *administrative agent* for transfers between Defendants and BLMIS. (Pomerantz Report ¶ 18 n.18 (Newman Decl., Ex. B); Deposition Transcript of Dr. Steve Pomerantz, Jan. 8, 2012, 178:13-183:8 (Newman Decl., Ex. D).[8]) To impute the knowledge of an agent to a principal, the evidence must establish both that there was an agency relationship and that the knowledge to be imputed was acquired while acting within the scope of that agency. *See, e.g.*, *Center v. Hampton*

[7] Indeed, the record set out by the Trustee in exhibits to the Complaint demonstrates no coordination whatsoever of the transfers to and from BLMIS. To the contrary, they vary considerably from account to account in amount and timing.

[8] References to the "Newman Decl." and its attached exhibits are to the Declaration of David C. Newman, dated January 26, 2012 and filed in support of Defendants' Motion to Strike the Expert Reports and Testimony of Steve Pomerantz and Harrison J. Goldin.

Affiliates, Inc., 66 N.Y.2d 782, 784 (1985); N.Y. P'ship Law § 23 (knowledge of a partner must be "the knowledge of the partner acting in the particular matter").

There is no evidence that either the Sterling Equities partnership or Mr. Friedman was ever appointed an agent by the other Defendants to do anything beyond purely administrative functions with respect to their accounts. Most particularly, Mr. Friedman had no authority to make investment decisions, other than his own, and certainly no control—he could not decide, nor did he, whether or when to deposit or withdraw funds for any Defendant's BLMIS account. (Rule 56.1 ¶¶ 99-100.) For the convenience of Defendants, Mr. Friedman did act as the contact point with BLMIS, collecting and transmitting transfers to and from BLMIS and receiving account statements, confirms and other documentation. (*Id.* ¶¶ 101-02.) His role, however, was purely ministerial, and, therefore, the scope of his agency was similarly narrow and cannot be a basis for imputing willful blindness. *See, e.g.*, *Hampton Affiliates, Inc.*, 66 N.Y.2d at 784; *Van Ostrand v. Nat'l Life Assurance Co. of Canada*, 371 N.Y.S.2d 51, 56-57 (N.Y. Sup. Ct. 1975).

Finally, the Trustee argues that because some Defendants participated in a coordinated effort to restructure Sterling-related debt *after* Madoff's fraud was revealed, coordinated activity may be inferred with respect to investment decisions made *before* the fraud was revealed. (*See* Compl. ¶¶ 853-64.) To state the argument is to refute it. Steps taken to salvage the situation following the devastating losses caused by Madoff's fraud have no bearing on individual investment decisions made years before, and there is no evidence to demonstrate that they did.

III. SUMMARY JUDGMENT MUST BE GRANTED WITH RESPECT TO ALL DEFENDANTS AS TO WHICH NO CLAIM REMAINS

Summary judgment is sought for all Defendants as to each of the remaining three counts. There are no claims against some Defendants because (a) as to Count One, they withdrew no funds in the two years before the BLMIS filing (*see* Appendix A); (b) as to Count Nine, they received no subsequent transfers from a transferee whose transfers are challenged under Count One; and (c) as to Count Eleven, they have asserted no claim against BLMIS (*see* Appendix B). Moreover, no claim may be asserted against any Defendant with respect to Count Nine. Because the Trustee cannot avoid any initial transfers as fraudulent, no subsequent transfer avoidance claim may lie, and the Trustee cannot factually support his subsequent transfer claims.

Attached hereto as Appendix C is a list of those Defendants who are not alleged to have received any initial or subsequent transfers during the relevant two-year period and against whom the Trustee has not asserted an equitable subordination claim. Accordingly, these Defendants are entitled to summary judgment for the independent reason that no claim is asserted against them.

CONCLUSION

For the reasons set forth above, Defendants respectfully request that the Court enter judgment in favor of Defendants dismissing the remaining claims in the Complaint in their entirety.

Dated: New York, New York
January 26, 2012

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APPENDIX A

Defendants Not Subject to Count One (11 U.S.C. § 548(a)(1)(A))[1]

157 J.E.S. LLC	Mets Partners, Inc.
Air Sterling LLC	Michael Schreier
Minor 1	Realty Associates Madoff II
BAS Aircraft LLC	Ruskin Garden Apartments LLC
Bon Mick Family Partners LP	Scott Wilpon
Bon-Mick, Inc.	SEE Holdings I
Minor 2	SEE Holdings II
Brooklyn Baseball Company LLC	Sterling American Property III LP
Bruce N. Wilpon	Sterling American Property IV LP
C.D.S. Corp.	Sterling Brunswick Corporation
Charles 15 Associates	Sterling Equities
Charles 15 LLC	Sterling Equities Investors
Charles Sterling LLC	Sterling Jet Ltd.
Coney Island Baseball Holding Company LLC	Sterling Jet II Ltd.
Daniel Wilpon	Sterling Mets Associates
Heather Katz Knopf	Sterling Mets Associates II
Howard Katz	Sterling Pathogenesis Company
Jessica Wilpon	Sterling Third Associates
Kimberly Wachtler	Todd Katz
Mets II LLC	Valley Harbor Associates
Mets One LLC	

[1] The information set forth in Appendices A through C is based on a review and analysis of the Complaint and Appendix II, Exhibits B, C, and E attached thereto.

APPENDIX B

Defendants Not Subject to Court Eleven (11 U.S.C. § 510(c)(1))

157 J.E.S. LLC	SEE Holdings II
Air Sterling LLC	Sterling Acquisitions LLC
BAS Aircraft LLC	Sterling American Advisors II LP
Bon-Mick, Inc.	Sterling American Property III LP
Brooklyn Baseball Company LLC	Sterling American Property IV LP
Charles 15 Associates	Sterling American Property V LP
Charles 15 LLC	Sterling Brunswick Corporation
Charles Sterling LLC	Sterling Equities Associates
Coney Island Baseball Holding Company LLC	Sterling Equities Investors
Edward M. Tepper	Sterling Heritage LLC
Kimberly Wachtler	Sterling Jet Ltd.
Michael Schreier	Sterling Jet II Ltd.
Realty Associates Madoff II	Sterling Pathogenesis Company
Ruskin Garden Apartments LLC	Sterling Third Associates
SEE Holdings I	Valley Harbor Associates

APPENDIX C

Defendants Against Which No Claim Remains

157 J.E.S. LLC	Ruskin Garden Apartments LLC
Air Sterling LLC	Sterling American Property III LP
BAS Aircraft LLC	Sterling American Property IV LP
Bon-Mick, Inc.	Sterling Equities Investors
Brooklyn Baseball Company LLC	Sterling Jet Ltd.
Charles 15 Associates	Sterling Jet II Ltd.
Charles 15 LLC	Sterling Pathogenesis Company
Coney Island Baseball Holding Company LLC	Sterling Third Associates
Realty Associates Madoff II	Valley Harbor Associates