19-429(L)

19-443(CON), 19-501(CON), 19-510(CON)

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

In Re: BERNARD L. MADOFF INVESTMENT SECURITIES LLC,

IRVING H. PICARD, TRUSTEE FOR THE LIQUIDATION OF BERNARD L. MADOFF INVESTMENT SECURITIES LLC, AND BERNARD L. MADOFF,

Plaintiff-Appellee,

(*Caption continued on inside cover*)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

PAGE PROOF BRIEF FOR PLAINTIFF-APPELLEE

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—against—

EMANUEL GETTINGER, SOUTH FERRY BUILDING COMPANY, ABRAHAM WOLFSON and ZEV WOLFSON, UNITED CONGREGATIONS MESORA, SOUTH FERRY #2 LP, TURTLE CAY PARTNERS, COLDBROOK ASSOCIATES PARTNERSHIP, INDIVIDUALLY AND IN ITS CAPACITY AS GENERAL PARTNER OF TURTLE CAY PARTNERS, THE ESTATE OF MARIANNE LOWREY, JAMES LOWREY, CAPACITY AS GENERAL PARTNER OF TURTLE CAY PARTNERS, CAPACITY AS PERSONAL REP OF ESTATE OF MARIANNE LOWREY, CAPACITY AS TRUSTEE FOR MARIANNE B. LOWREY TRUST, & CAPACITY AS SUCCESSOR PARTNER COLDBROOK ASSOCIATES PARTNER, AARON WOLFSON,

Defendants-Appellants,

ABRAHAM ADEFF, GOLDIE APPELGRAD, SIMCHA APPELGRAD, DAVID G. AVIV, B.F.&W. REALTY COMPANY, MIRIAM BEREN, ZELDA ELBAUM, RAZEL FASKOWITZ, ROSLYN GETTINGER, MORRIS GOLDSTEIN, SAMUEL GOLDSTEIN, MR. ISRAEL GROSSMAN, KALMAN HALPERN, ZEVI HARRIS, JOSEPH KATZ, BESSIE KAUFMAN, DAVID KAUFMAN, A. TRUST, A.N. TRUST, A.O.N. TRUST, AA. TRUST, AARON TRUST, ABRAHAM TRUST, ABRAHAM N. TRUST, AL. TRUST, ALISA TRUST,

Defendants,

SECURITIES INVESTOR PROTECTION CORPORATION,

Intervenor.

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PRELIMINARY STATEMENT

It is settled law that a Ponzi-scheme investor does not give "value" in exchange for the withdrawal of fictitious profits. As a result, the investor has no "for value" defense to a trustee's avoidance action. That is the rule under the Bankruptcy Code, the Securities Investor Protection Act ("SIPA"), and debtor-creditor law generally.

That simple rule resolves this case. It is undisputed that Bernard L. Madoff Investment Securities LLC ("BLMIS") was a Ponzi scheme and that Appellants withdrew funds in excess of their principal deposits with BLMIS. Although Appellants here may keep their principal, their asserted legal right to profit from Bernard Madoff's fraud is as untenable as it sounds. The position has been rejected in every case to have encountered it, and the district court previously found no substantial ground for difference of opinion on this point.

SIPA, the statute that governs broker-dealer liquidations, tolerates no other result. SIPA segregates "customer property" claims from general creditor claims to ensure an expedited and maximized return of property belonging to a failed broker's customers. Appellants' asserted claims of "value" in exchange for fictitious profits are nothing but disguised damages claims arising from Madoff's fraud. Courts uniformly hold that in a SIPA liquidation, damages claims cannot deplete the fund of customer property unless and until all priority claims are paid.

Appellants have already received a return of their principal, and then some. Allowing them to retain fictitious profits under the guise of a value defense puts their claims ahead of others, in violation of SIPA and this Court's opinions interpreting that statute.

This Court held that a customer's principal, and not the fraudulent profits Madoff falsely said he procured, reflects the recovery to which customers are entitled, and the Court relied on fraudulent-transfer law in reaching this conclusion. Countenancing Appellants' position that profits never truly earned constitute "value" means that other customers will lose their unrecovered principal. Every dollar of profit to one customer is loss to another. Congress addressed that reality in SIPA; it balanced the equities by empowering the Trustee to avoid transfers of customer property marred by actual fraudulent intent, and the district court correctly interpreted Congress's words and will. Its judgment should be affirmed.

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 1334(b) and SIPA §§ 78eee(b)(2)(A) and 78eee(b)(4). The district court had jurisdiction under 28 U.S.C. §§ 1331 and 1334(b). This is a consolidated appeal from final orders granting the Trustee's motions for summary judgment. This Court has jurisdiction under 28 U.S.C. § 1291.

COUNTERSTATEMENT OF ISSUES PRESENTED

1. Whether the district court correctly held that Appellants, who received fictitious profits from BLMIS, did not take them in exchange "for value" under section 548(c) of the Bankruptcy Code, 11 U.S.C. § 548(c).

2. Whether the district court correctly entered judgment for the Trustee where the Trustee calculated Appellants' avoidance liability using the net investment method and he sought to avoid transfers of net profits made to Appellants within the two-year period prior to the liquidation.

COUNTERSTATEMENT OF THE CASE

A. Madoff's Ponzi Scheme

There is no dispute that Madoff operated BLMIS as a Ponzi scheme. Adv. Pro. No. 10-04488, ECF No. 83 ("South Ferry Stip.") ¶ 10; Adv. Pro. No. 10-04387, ECF No. 75 ("Lowrey Stip.") ¶ 10; Adv. Pro. No. 10-05110, ECF No. 57 ("Mesora Stip.") ¶ 10; Adv. Pro. No. 10-04350, ECF No. 90 ("SF #2 Stip.") ¶ 10. Madoff claimed to utilize a "split-strike conversion" strategy, combining purchases of stocks listed on the Standard & Poor's 100 Index with purchases of corresponding options and purchases of treasury bills when he was purportedly out of the market. *In re BLMIS*, 654 F.3d 229, 231 (2d Cir. 2011), *cert. denied*, 133 S. Ct. 24 (2012) ("*Net Equity Decision*").

In fact, Madoff did not execute any strategy—split-strike conversion or otherwise—and could "not possibly have done so." *Id.* at 232. "The investment advisory business . . . did not actually trade securities for customers and did not generate any legitimate profits for customer accounts." South Ferry Stip. ¶ 13; Lowrey Stip. ¶ 13; Mesora Stip. ¶ 13; SF #2 Stip. ¶ 13. These funds "were never exposed to the uncertainties or fluctuations of the securities markets," *Net Equity Decision*, 654 F.3d at 232, but instead were commingled in a checking account used to satisfy the withdrawal requests of other customers. *See SIPC v. BLMIS (In re BLMIS)*, 424 B.R. 122, 129 (Bankr. S.D.N.Y. 2010) ("*Bankr. Net Equity Decision*"); South Ferry Stip. ¶ 12; Lowrey Stip. ¶ 12; Mesora Stip. ¶ 12; SF #2 Stip. ¶ 12.

Madoff generated monthly account statements showing fictitious trades for each customer account. *See Net Equity Decision*, 654 F.3d at 231; *see also* Lowrey Stip. ¶ 50 ("[Appellant] received monthly Account statements from BLMIS reporting purported securities transactions effected on their behalf. At all times, BLMIS defrauded the [] Defendants by intentionally misrepresenting the purported securities transactions in the Accounts"); Mesora Stip. ¶ 36 (same); South Ferry Stip. ¶ 34 (same); SF #2 Stip. ¶ 34 (same). These fabricated statements bore no relation to the real world: they were "generated based on after-the-fact stock 'trades' using already-published trading data to pick advantageous historical prices." *Net Equity Decision*, 654 F.3d at 232. "At bottom, the BLMIS customer statements were bogus and reflected Madoff's fantasy world of trading activity, replete with fraud and devoid of any connection to market prices, volumes, or other realities." *Bankr. Net Equity Decision*, 424 B.R. at 130. The customer statements reflected "unvarying investor success; but the only accurate entries [in Madoff statements] reflected customer's cash deposits and withdrawals." *Net Equity Decision*, 654 F.3d at 232.

B. The SIPA Liquidation

Like every Ponzi scheme, Madoff's "used the investments of new and existing customers to fund withdrawals of principal and supposed profit made by other customers." *Id.*; South Ferry Stip. ¶¶ 12, 16; Lowrey Stip. ¶¶ 12, 16; SF #2 Stip. ¶¶ 12, 16; Mesora Stip. ¶¶ 12, 17. By withdrawing profits before the scheme collapsed, Appellants reaped the benefit of Madoff's "dreamt-up rates of return" at the expense of other investors who had not yet received their principal. *Net Equity Decision*, 654 F.3d at 232. And once the flow of money no longer supported withdrawals, the Ponzi scheme collapsed. The Securities Investor Protection Corporation ("SIPC") petitioned for a protective decree placing BLMIS into liquidation and appointing the Trustee.

In a SIPA liquidation, the Trustee focuses on returning property to customers promptly. SIPA § 78fff(a). To do this, SIPA creates a fund of "customer property," separate from and in priority to the general estate, for distribution to the debtor's customers. *See Net Equity Decision*, 654 F.3d at 233.

Each customer shares ratably in this fund of assets to the extent of their net equity. *See id*. "Net equity" is defined as the amount the broker would have owed to the customer if the broker liquidated the customer's securities positions on the liquidation date, plus the cash deposited by the customer to purchase securities, less any amounts owed by the customer to the broker. *See* SIPA § 78*lll*(11).

To satisfy customers from the fund of customer property, SIPA empowers a trustee to recover customer property wrongfully transferred or unlawfully converted by the brokerage firm. *See* SIPA §§ 78*lll*(4), 78fff-2(c)(3). By litigating or settling with recipients of customer property and distributing that property *pro rata* among customers, SIPA facilitates the avoidance and recovery of customer property and "achieve[s] a fair allocation of the available resources among the customers . . . ." *Net Equity Decision*, 654 F.3d at 240; *see also SIPC v. BLMIS* (*In re Madoff Sec.*), 779 F.3d 74, 81 (2d Cir. 2015) ("*Time-Based Damages Decision*").

In this SIPA liquidation, the Trustee employs a "net investment method" to both determine customer claims and calculate avoidance liability. The net investment method offsets the amount of money each customer deposited with the money withdrawn by that customer from BLMIS. Customers who withdrew less money than they invested have allowable customer claims against the BLMIS estate in the amount of their net losses. *See Bankr. Net Equity Decision*, 424 B.R.

at 132. Conversely, customers who withdrew more money than they invested do not have allowable customer claims and are subject to avoidance actions to recover the fictitious profits they received in excess of their principal investment. *See Picard v. Greiff*, 476 B.R. 715, 729 (S.D.N.Y. 2012) ("*Greiff*"), *aff'd on other grounds*, 773 F.3d 411 (2d Cir. 2014), *cert. denied*, 135 S. Ct. 2859 (2015). All customers, assuming they filed claims before the bar date, may have state law and other claims against the general estate stemming from Madoff's fraud. *See id.* at 727-28.

In 2011, this Court upheld the use of the net investment method, deeming it equitable and consistent with SIPA because it preserved the separate customer fund for priority distribution to those customers who had not yet recovered their principal. *Net Equity Decision*, 654 F.3d at 238−39. Otherwise, "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.*

C. Appellants' Accounts

Appellants maintained six accounts at BLMIS and the material facts regarding these accounts are undisputed. Each Appellant entered into an account agreement with BLMIS, authorizing BLMIS to make trades and exercise investment discretion on their behalf. Each Appellant received monthly statements from BLMIS purporting to state the value of securities in the accounts. The statements sent to each Appellant were false, reflecting fictitious trades and profits. Although Appellants did not know of Madoff's fraud, Appellants withdrew millions of dollars of fake profits from the Ponzi scheme. *See* South Ferry Stip. ¶¶ 17, 19, 25, 34–36; SF # 2 Stip. ¶¶ 17, 19, 25, 34–36; Lowrey Stip. ¶¶ 17, 19, 22, 25, 27, 30, 33, 35, 38, 50-52; Mesora Stip. ¶¶ 18, 20, 24, 26, 36–38.

Following a decision of this Court on the section 546(e) safe harbor, *Picard v. Ida Fishman Revocable Trust*, 773 F.3d 411 (2d Cir. 2014) ("*Fishman*"), as against good faith defendants like Appellants, the Trustee is limited to asserting claims under section 548(a)(1)(A) of the Bankruptcy Code—actually fraudulent transfers made within two years prior to the commencement of the liquidation. *See SIPC v. BLMIS*, 596 B.R. 451, 458 (S.D.N.Y. 2019) ("*Summary Judgment Decision*").

The Trustee's avoidance action against Appellants seeks to recover $41,295,673—the total amount of fictitious profits Appellants received during the two-year period preceding the liquidation. Because of *Fishman*, $13,235,000 of fictitious profits that Appellants received prior to that time are not subject to avoidance.

D. The Trustee's Recovery Action

Appellants concede that BLMIS was a Ponzi scheme and that BLMIS made the transfers to them in the two-year period with actual fraudulent intent. They further acknowledge that they possess fictitious profits—*i.e.*, other customers' principal. *See* South Ferry Stip. ¶¶ 12–16; SF #2 Stip. ¶¶ 12–16; Lowrey Stip. ¶¶ 12–16; Mesora Stip. ¶¶ 12–16. Yet Appellants seek to retain these imaginary profits by raising various defenses to the Trustee's avoidance actions. None are new. And all have been roundly rejected by every court to consider them.

The assertion that net winners like Appellants provide value for fictitious profits through the satisfaction of an antecedent debt was first considered by Judge Rakoff on a motion to withdraw the reference to the bankruptcy court in 2012. *See generally Greiff*, 476 B.R. 715. In rejecting this argument, the district court noted that "every circuit court to address this issue has concluded that an investor's profits from a Ponzi scheme, whether paper profits or actual transfers, are not 'for value.'" *Id.* at 725 (citing *Donell v. Kowell*, 533 F.3d 762, 771–72 (9th Cir. 2008), *cert. denied*, 555 U.S. 1047 (2008)). As such, even if defendants-transferees possessed valid claims under state or federal law, transfers in excess of principal were not for value. *Id.* The district court further held that treating claims that arise under state or federal law as value would conflict with the priority scheme created by SIPA by "equating net equity and general creditor claims." *Id.* at 727.

Although Appellants were not parties to the *Greiff* proceeding, they were parties to the next proceeding before Judge Rakoff that involved substantially identical issues. Appellants (and other customers) successfully moved to withdraw the reference and then moved to dismiss, submitting a consolidated brief to the district court raising the same arguments Appellants made below. *SIPC v. BLMIS*, Adv. Pro. No. 08-01789, 2018 WL 1442312, at *6 (Bankr. S.D.N.Y. Mar. 22, 2018) ("*R&R*"). Once again, Judge Rakoff rejected Appellants' value arguments under section 548(c) of the Bankruptcy Code, holding that in Ponzi-scheme cases, courts consistently reject claims against the estate in excess of principal invested. *SIPC v. BLMIS (In re BLMIS)*, 499 B.R. 416, 422 (S.D.N.Y. 2013) ("*Antecedent Debt Decision*"). The district court emphasized that customer statements could not create valid state law claims because the fictitious statements were invalid and unenforceable. *Id.* at 421 n.4.

The district court further reiterated that, even if Appellants did hold valid claims, their position was inconsistent with SIPA and the separate estates it creates. *Id.* at 422. "[T]he definition of net equity and the definition of claims that can provide 'value' to the customer property estate are inherently intertwined." *Id.* at 424. The customer property estate can only be used to satisfy net equity claims; state and federal claims must be lodged against the general estate and cannot be exchanged "for value" against the customer property estate. *Id.*; *see also*

Rosenman Family, LLC v. Picard, 395 F. App'x 766, 768 (2d Cir. 2010) (customer "claims are satisfied from a customer property estate, which is separate from the general estate used to satisfy the claims of general unsecured creditors); *In re Adler Coleman Clearing Corp.*, 195 B.R. 266, 270 (Bankr. S.D.N.Y. 1996) (SIPA affords those who qualify as "'customers' of the debtor priority over the distribution of 'customer property'") (quoting *Stafford v. Giddens (In re New Times Sec. Servs., Inc.)*, 463 F.3d 125, 127 (2d Cir. 2006)); *CarVal UK Ltd. v. Giddens (In re Lehman Bros., Inc.)*, 791 F.3d 277, 281 (2d Cir. 2015) (SIPA trustees administer "a bankruptcy within a bankruptcy" for investors whose property was held by broker-dealer where trustee collects customer property and each customer shares ratably in that fund) (internal citations omitted).

The district court also rejected Appellants' contention that the Trustee was improperly asserting rights beyond those of a traditional bankruptcy trustee. First, the court noted that the Bankruptcy Code applies in a SIPA liquidation only to the extent the Code is consistent with SIPA. *Antecedent Debt Decision*, 499 B.R. at 423 (citing SIPA § 78fff(b)). Thus, it reasoned, the Trustee has the same avoidance powers as a Chapter 11 trustee, but those powers must be "interpreted through the lens of SIPA's statutory scheme." *Id.* at 423. For this reason, the value defense under section 548(c) does not apply the same way to the customer property estate in a SIPA case as it does to the general estate. *Id.* at 423−24. The district court found that allowing Appellants to use their general creditor claims of "value" against the customer property estate would upset the priority scheme created by SIPA to protect brokerage customers. *Id.* at 424−25.

Appellants also claimed that the Trustee applied the net investment method incorrectly when calculating Appellants' avoidance liability, arguing instead that their net-profits calculation should be reset as of the beginning of the two-year period. The district court disagreed: "there is no reason why a line should be drawn at the beginning of the reach-back period in determining whether a transfer was for value." *Id.* at 427. The court emphasized that "the concept of harm or benefit to the estate is separate from the concept of the reach-back period, which merely serves to allow finality to ancient transactions." *Id.* Finally, the district court concluded that the Trustee's use of the net investment method "harmonize[d] the avoidance and recovery scheme with the Second Circuit's [*Net Equity Decision*] upholding the Trustee's net-equity calculation, even if the issue of the scope of the Trustee's avoidance power was not explicitly before the Second Circuit in that case." *Id.*

Finally, Appellants argued that the Trustee's claims were barred by the two-year statute of limitations. The district court quickly dispatched this argument, concluding that the Trustee properly sought to avoid transfers that occurred within the two-year look-back period provided in section 548(a)(1)(A). *Id.* at 427; *see* *also Greiff*, 476 B.R. at 729. The court noted that although section 548(a)(1) permits the Trustee to avoid only those transfers occurring in the two-year period, there is no such limitation in section 548(c) concerning the determination of whether the transactions provided value. *Id.* at 723−24.

Appellants and other customers moved for an interlocutory appeal. The district court denied Appellants' motion, finding no substantial difference of opinion on its holding. *SIPC v. BLMIS*, 987 F. Supp. 2d 309, 311 (S.D.N.Y. 2013). Decisions rendered after the *Antecedent Debt Decision* and denial of the interlocutory appeal, but before the decisions below that led to this appeal, reached the same result as the district court on the issue of value. *See SIPC v. BLMIS (In re Bernard L. Madoff)*, 531 B.R. 439, 461−62 (Bankr. S.D.N.Y. 2015) ("*Omnibus Good Faith Decision*"); *Picard v. Cohen*, Adv. Pro. No. 10-04311, 2016 WL 1695296, at *7−15 (Bankr. S.D.N.Y. April 25, 2016).

Upon return to the bankruptcy court, the parties stipulated to material facts and filed dueling summary judgment motions. The bankruptcy court (Bernstein, J.), following the *Antecedent Debt Decision*, recommended that summary judgment be entered for the Trustee. *R&R*.[1] The district court (Engelmayer, J.)

[1] After the R&R was entered, the Bankruptcy Court reiterated its holding on value in two subsequent cases in this liquidation, *SIPC v. BLMIS*, Adv. Pro. No. 10-04946, 2018 WL 3078149, at *4−5 (Bankr. S.D.N.Y. June 19, 2018), and *SIPC v. BLMIS*, Adv. Pro. No. 10-05286, 2019 WL 2593008, at *11−13 (Bankr. S.D.N.Y. June 25, 2019).

adopted that recommendation, granting the Trustee's motion and denying Appellants' motion. *Summary Judgment Decision*, 596 B.R. at 472.

Judge Engelmayer found that all arguments raised by Appellants at the summary judgment stage were raised at the motion-to-dismiss stage "and—rightly—rejected by Judge Rakoff in *Greiff* and [the] *Antecedent Debt Decision*." *Id.* at 463. The district court again emphasized that courts routinely reject claims to recover amounts in excess of the investor's principal in Ponzi-scheme cases. *Id.* at 464. And, aside from the fact that "their claims to recoup more [than their initial investment] would not qualify as antecedent debts in the first place," Appellants' position conflicts with SIPA. *Id.* "[E]ven assuming the antecedent debts were valid, they cannot be the basis of the retention of customer property," which is afforded unique protection under SIPA. *Id.* at 464–65 (internal marks omitted). As to the statute of limitations, the court again faulted Appellants for confusing the two-year limitations period with the calculation of "value" exchanged. *Id.* at 470–72. The district court reiterated its prior holdings, found them binding under the law-of-the-case doctrine, and rejected Appellants' efforts to evade them. *Id.* at 463–64. This appeal followed.

SUMMARY OF ARGUMENT

The district court correctly found that Appellants did not exchange value for their fictitious profits. Whether framed as a securities entitlement, an obligation owed by BLMIS to them, or as various federal and state law claims, Appellants simply have no right to payment from BLMIS that qualifies as an antecedent debt. To evade this unassailable conclusion, Appellants argue that this Court's *Fishman* decision changed the legal landscape so dramatically that they are now entitled to retain all imaginary profits engineered by Bernard Madoff.

That is not the case. This Court's decision in *Fishman* did not address the concept of a value defense and does not alter the voluminous body of case law supporting the common-sense principle that a transferee cannot give value for Ponzi profits. That is the case under the Bankruptcy Code and is particularly true in a SIPA liquidation where the priority scheme created by the statute mandates that claims against the general estate—like the state and federal law claims all BLMIS customers may have—cannot be set off against customer property.

With no valid defense under section 548(c), Appellants make a last-ditch effort to retain fictitious profits by arguing that the Trustee wrongly calculated their avoidance liability and cannot avoid the transfers in the two-year limitations period because purported obligations arose before that time. These efforts should be rejected outright. Appellants stipulated that BLMIS made transfers of fictitious profits to them in the two-year period. And the amounts sought by the Trustee are consistent with the body of case law—addressing this Ponzi scheme and others—establishing the calculation for avoidance liability and which transfers are recoverable. The Bankruptcy Code, SIPA, and this Court's decisions provide for the avoidance and recovery of the transfers to Appellants within the two-year period in the amounts sought.

The district court's decision should be affirmed.

STANDARD OF REVIEW

This Court reviews the district court's ruling on a summary judgment motion *de novo* "by applying the same standard as the district court applied" under Federal Rule of Civil Procedure 56(c). *Repp v. Webber*, 132 F.3d 882, 889 (2d Cir. 1997).

ARGUMENT

I. APPELLANTS DID NOT GIVE "VALUE" IN EXCHANGE FOR FICTITIOUS PROFITS

The Bankruptcy Code and SIPA authorize the Trustee to avoid actual fraudulent transfers made by the debtor within the two-year period preceding the liquidation. 11 U.S.C. § 548(a)(1)(A); SIPA § 78fff-2(c)(3) (incorporating this avoidance power into SIPA). Appellants "do not dispute that the Trustee has made out a *prima facie* case to avoid [actual] fraudulent transfers." *Summary Judgment Decision*, 596 B.R. at 463. "Nor could they." *Id.* "Proof of a Ponzi scheme is sufficient to establish the Ponzi operator's actual intent to hinder, delay, or defraud creditors for purposes of actually fraudulent transfers under Bankruptcy Code § 548(a)(1)." *In re Cohen*, 199 B.R. 709, 717 (B.A.P. 9th Cir. 1996); *see also SEC v. Res. Dev. Int'l, LLC*, 487 F.3d 295, 301 (5th Cir. 2007) (same). The parties agree that Madoff operated BLMIS as a Ponzi scheme and transferred funds from the scheme to Appellants, and did so with actual fraudulent intent. South Ferry Stip. ¶ 27; SF #2 Stip. ¶ 27; Lowrey Stip. ¶ 42; Mesora Stip. ¶ 29.

The burden then shifts to Appellants to show that they have a valid defense. Section 548(c) of the Bankruptcy Code provides that a defendant may retain fraudulent transfers received for value and in good faith (the latter of which is not at issue in this proceeding). Value includes satisfaction of an antecedent debt, and "[d]ebt" is defined in the Code as "liability on a claim." 11 U.S.C. § 101(12). "Claim" means "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A).

The issue presented here is whether Appellants can show that they have a right to payment for the transfers of fictitious profits. Put another way, they must show that the transfers of fictitious profits satisfied an antecedent debt owed to them by BLMIS. Appellants set forth a variety of inconsistent and complex theories in an effort to recast their fictitious profits as value. No amount of creativity, however, can alter what has been definitively held by this Court and others: innocent investors in a Ponzi scheme are entitled to keep only those transfers equal to their principal investments.

A. Appellants Have No Restitution or Rescission Claims that Qualify as an Antecedent Debt

Courts routinely hold that payments in excess of principal to "Ponzi scheme investors should be treated as fraudulent transfers, because 'fair consideration' is not present in the context of such schemes." *Silverman v. Cullin*, 633 F. App'x 16, 17 (2d Cir. 2016). This consensus holds that Ponzi-scheme investors are entitled to a for-value defense only to the extent of their investment; their profits are not protected. *See Scholes v. Lehmann,* 56 F.3d 750, 757 (7th Cir. 1995); *In re Hedged-Investments Assocs., Inc.*, 84 F.3d 1286, 1290 (10th Cir. 1996); *Donell*, 533 F.3d at 772; *Perkins v. Haines*, 661 F.3d 623, 628 (11th Cir. 2011); *Armstrong v. Collins*, No. 01 Civ. 2437, 2010 WL 1141158, at *22 (S.D.N.Y. Mar. 24, 2010). In substance, these profits "belong[] to the other investors." *In re M & L Bus. Mach. Co., Inc.*, 160 B.R. 851, 857 (Bankr. D. Colo. 1993).[2]

[2] Appellants make much hay about the fact that these decisions involve equity investors or are receivership cases. But none of the courts below were persuaded by that distinction, calling it one without a difference. *See Summary Judgment Decision*, 596 B.R. 451; *Antecedent Debt Decision*, 499 B.R. 416; *Greiff*, 476 B.R. 715. As Judge Rakoff found in *Greiff*, the fact that BLMIS styled itself as a stockbroker does not determine how courts treat fictitious profits. 476 B.R. at 726–27. And "no court has distinguished between equity investments and debt-based claims when applying the general rule to fraudulent transfer actions arising out of a Ponzi scheme." *Perkins*, 661 F.3d at 627. Appellants give this Court no reason to be the first.

Therefore, in a Ponzi scheme, investors have claims for rescission or restitution against the debtor up to the amount of their principal invested. The "[p]ayments up to the amount of the initial investment are considered to be exchanged for 'reasonably equivalent value,' and thus not fraudulent, because they proportionally reduce the investors' rights to restitution." *Donell*, 533 F.3d at 772 (citing *In re United Energy Corp.,* 944 F.2d 589, 595 (9th Cir. 1991)); *see also In re Bayou Grp., LLC,* 439 B.R. 284 (S.D.N.Y. 2010) (defendants "gave value in the form of their initial investments, and have tort claims of rescission to recover all of their initial investment based on fraudulent inducement"); *Omnibus Good Faith Decision*, 531 B.R. at 462 (same); *Antecedent Debt Decision*, 499 B.R. at 421 n.4 (same); *Greiff*, 476 B.R. at 724–25 (same).

If, however, investors receive more than they invested, a trustee is permitted to recover those payments of fictitious profits as fraudulent because "they do not represent a return on legitimate investment activity." *Donell*, 533 F.3d at 772 (citing *Collins v. Sellis* (*In re Lake States Commodities Inc.*), 253 B.R. 866, 872 (N.D. Ill. 2000)). Thus, courts refuse to allow a transferee in a Ponzi scheme to retain fictitious profits in a fraudulent transfer action because the transferee has no remaining rescission claim for the amounts in excess of principal, having already received full return of the amounts they invested. *See Greiff*, 476 B.R. at 729. The transactions are "assessed on the basis of what they really were; and they really were artificial transfers designed to further the fraud, rather than any true return on investments." *Id.* at 725.

Accordingly, "[t]he loss of an opportunity to lay hands on funds belonging to others is not a legally cognizable injury." *Trs. of the Upstate N.Y. Eng'rs Pension Fund v. Ivy Asset Mgmt.*, 843 F.3d 561, 568 (2d Cir. 2016) ("*Ivy Asset Mgmt.*"). In *Ivy Asset Management*, this Court "decline[d] to measure loss based on the amount of other investors' money that the Plan could have withdrawn" because "a missed chance for innocent enjoyment of a fraud" cannot constitute a legal claim—lest the Court "lend its power to assist or protect a fraud." *Id.* (citation omitted).

The same principle applies here: "To allow an investor to enforce his contract to recover promised returns in excess if his investment would be to further the debtors' fraudulent scheme at the expense of other investors." *In re Hedged-Investments Assocs., Inc.*, 84 F.3d at 1290 (internal marks omitted). Because the underlying claim cannot be recognized, it is not an antecedent-debt satisfaction but rather a "gratuitous payment" made "without consideration." *Eby v. Ashley*, 1 F.2d 971, 973 (4th Cir. 1924); *SIPC v. BLMIS*, Adv. Pro. No. 08-01789, 2019 WL 3436542, at *5 (Bankr. S.D.N.Y. July 26, 2019) ("Though innocent of Madoff's fraud, the Diana Trust has no right as a matter of equity to enjoy the fruits of that fraud at the expense of equally innocent victims who have lost their principal investments.”).

Here, Appellants concede that they have received back all of the principal they invested with BLMIS. *See* South Ferry Stip. ¶ 24–25; SF #2 Stip. ¶ 24–25; Lowrey Stip. ¶ 21–22, 29–30, 37–38; Mesora Stip. ¶ 25–26. Because Appellants “have recovered their initial investment with BLMIS, their claims to recoup more [do] not qualify as antecedent debts in the first place.” *Summary Judgment Decision*, 596 B.R. at 464 (citing *In re Bayou Gr., LLC*, 439 B.R. at 309). Appellants’ claims for rescission or restitution are already fully satisfied by the return of their principal and do not allow them to retain fictitious profits or recast them as transfers for value.

B. Appellants Filed No Claims Against the Debtor that Could Suffice as Value

Appellants next claim that they have various state law and federal securities claims against the debtor that suffice as “value” under section 548(c), including claims for breach of contract, fraudulent inducement, and violations of federal securities law. Br. 29–37. As an initial matter, Appellants did not actually file any non-bankruptcy law claims against BLMIS. The bar date to file a claim against the debtor (customer claim, general creditor claim, or otherwise) ran on July 2, 2009 and Appellants did not file any claims. Moreover, the statute of limitations for such claims has long since run. *See Domenikos v. Roth*, 288 F. App’x 718, 720 (2d

Cir. 2008) ("Section 804(b) of SOX extended the limitations period for securities fraud actions to the lesser of two years from discovery of the fraud or five years from the date of the fraud."); *Sedona Corp. v. Ladenburg Thalman & Co.*, No. 03 Civ. 3120, 2005 WL 1902780, at *7 (S.D.N.Y. Aug. 9, 2005) (stating that under 28 U.S.C.A. 1658(b) "a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of . . . the [federal] securities laws . . . may be brought not later than the earlier of-(1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation").

Appellants cite no case law in support of their position that hypothetical, unrealized claims for non-specific amounts of damages that they never brought can be offset against transfers of fictitious profits as exchanges for value. And there is none.

C. BLMIS Had No Enforceable Obligations to Appellants

Appellants next posit that BLMIS had enforceable obligations to them arising under sections 28(a)(2) and 29(b) of the Exchange Act of 1934 (the "'34 Act"). Appellants believe that the fictitious profits they received satisfied those obligations. Appellants are wrong.

Judge Rakoff easily disposed of Appellants' arguments in *Greiff* and the *Antecedent Debt Decision*. In *Greiff*, Judge Rakoff held that BLMIS's account statements did not create binding obligations to BLMIS customers. 476 B.R. 715.

He held the same in the *Antecedent Debt Decision*, finding that the "account statements were not merely avoidable but were in fact invalid and thus entirely unenforceable." *Antecedent Debt Decision*, 499 B.R. at 421 n.4.

Appellants argue *Fishman*, issued after the *Greiff* and *Antecedent Debt* opinions, works to either overrule or undermine the reasoning of those opinions. Br. 27−29. Judge Engelmayer rejected this argument below, *Summary Judgment Decision*, 596 B.R. at 461, and this Court should as well.

Appellants overstate *Fishman*, claiming that a prior panel of this Court made two key holdings: (1) the monthly account statements created enforceable securities contracts, Br. 73, and (2) the settlement payments to Appellants satisfied unavoided obligations owed by the broker. Br. 62−63. But *Fishman* did neither.

The question before the *Fishman* panel was whether the safe harbor provision of section 546(e) shielded the avoidance of transfers under sections 544 and 548(a)(1)(B)—not the 548(a)(1)(A) transfers sought here.[3] *See Fishman,* 773 F.3d at 414−16. The Court looked at two components of section 546(e)—the meaning of "securities contract" and "settlement payment." *Id.* at 417−423. In rendering its decision, the Court relied on three BLMIS documents: a Customer

[3] *Fishman* acknowledged that "§ 546(e) is expressly inapplicable to claims of actual fraud brought under § 548(a)(1)(A)"—making it by its terms inapplicable here. 773 F.3d at 416. It therefore contemplated that these claims would proceed on remand, so Appellants' suggestion that the district court violated the mandate is simply wrong.

Agreement, a Trading Authorization, and an Option Agreement (collectively, the "Account Opening Documents"). *Id.* at 418. Although Appellants made extensive arguments to the panel about the validity of the monthly customer statements, *see* Joint Brief of Customer Appellees at 21−27, *Fishman*, No. 12-2557 (2d Cir. Oct. 11, 2013), ECF No. 265, the Court neither relied upon nor even mentioned them in its decision.

As to securities contracts, the Court found that the Account Opening Documents constituted "agreements by which BLMIS [would] 'acquire or dispose of securities' on behalf of its customers," and thus "[fell] within the statute's broad definition of 'securities contract[s].'" *Fishman,* 773 F.3d at 418−19 (citing 11 U.S.C. § 741(7)(A)(i)). As to settlement payments, the Court found that that the statutory definition of that term was broad enough to encompass "the transfer of cash or securities made to complete [a] securities transaction." *Id.* at 422 (quoting *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V. (In re Enron Creditors Recovery Corp.)*, 651 F.3d 329, 334 (2d Cir. 2011)). The Court found that when BLMIS customers requested a withdrawal from BLMIS, they "intended that BLMIS dispose of securities and remit payment to the customer." *Id.* (citing N.Y.U.C.C. § 8–501(b)(1) & cmt. 2). This was sufficient to render those transfers settlement payments under section 546(e).

But *Fishman* did not—as Appellants misleadingly claim—rely on the monthly account statements as the basis for its holding, nor did it endorse those monthly account statements as valid or enforceable in any way. To so hold would violate three of this Court's opinions. *See Net Equity Decision,* 654 F.3d at 234–35; *Time-Based Damages Decision,* 779 F.3d at 81; *SIPC v. BLMIS,* 522 B.R. 41, 47 (Bankr. S.D.N.Y. 2014) ("*Inter-Account Transfer Decision*"). This the *Fishman* panel did not do.

Nor does *Fishman* shed any light on the application of section 548(c). Indeed, it did not consider fraudulent transfers under section 548(a)(1)(A) at all because they are specifically carved out of section 546(e). The decision does not address the question of value and Appellants cite no basis to depart from decisions that have done so. "Unlike the situation under § 546(e), Congress has here created no 'safe harbor' to shelter receipts that might otherwise be subject to avoidance." *Greiff*, 476 B.R. at 725; *see also Summary Judgment Decision*, 596 B.R. at 467 ("Unlike § 546(e), there is no clear statutory direction that the satisfaction of claims against the general estate provides value for the fraudulent transfer of fictitious profits from the deposits made by other customers.").

Judge Engelmayer correctly found that *Fishman* did not present a basis for reconsidering the *Antecedent Debt Decision*, stating "[t]hat BLMIS's transfers were 'settlement payments' within the meaning of one statutory provision does not logically suggest that defendants gave 'value' within the meaning of a separate statutory provision when they received intentional fraudulent transfers of money." *Summary Judgment Decision*, 596 B.R. at 467. As Judge Engelmayer correctly noted, the "two issues are distinct matters of statutory construction and [are] very different." *Id.* By its terms, *Fishman* did not "convert a pre-filing diversion of customer property into the valid payment in satisfaction of the broker's antecedent debt." *R&R*, 2018 WL 1442312, at *12. Instead, it barred fraudulent transfer claims not at issue in this appeal.

Appellants try to wrap themselves in *Fishman* because their claims under section 29(b) of the Exchange Act fail. Appellants observe that, under this provision, "the innocent party" may "choose to enforce a securities contract" rather than rescind it. Br. 35. But it is no less true under the Exchange Act than other sources of law that "[t]he loss of an opportunity to lay hands on funds belonging to others is not a legally cognizable injury." *Ivy Asset Mgmt.*, 843 F.3d at 568. Nor does the Exchange Act confer value on profits never realized; an exchange of profits for nothing is not for fair equivalent value, and the Exchange Act does nothing to change that.

Appellants' reliance on the savings clause of section 28(a)(2) of the Exchange Act fares no better. Br. 36–37. This simply provides a "[r]ule of construction" that "the rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity." 15 U.S.C. § 78bbb(a)(2). This type of savings clause preserves a legal right that otherwise exists; it "does not represent an affirmative grant of power to the states," *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 210 (1983), much less a bestowal of real "substance" on an otherwise valueless transaction. *HBE Leasing Corp. v. Frank*, 48 F.3d 623, 638 (2d Cir. 1995). Appellants' claimed right to profit from fraud finds no support in any law, so there is nothing to be saved.

D. Appellants Have No Claims Under the UCC

Appellants next argue that, under the UCC, they have a right to payment for the full value of the securities positions that BLMIS falsely reported to its customers that allows them to retain fictitious profits. Br. 30. They do not.

As an initial matter, the UCC expressly states that it does not apply to SIPA liquidations. *See* N.Y.U.C.C. § 8-503 cmt. 1 (2009) ("[A]pplicable insolvency law governs *how the various parties having claims against the firms are treated*. For example, the distributional rules for stockbroker liquidation proceedings under the Bankruptcy Code and the Securities Investor Protection Act ("SIPA") provide that all customer property is distributed pro rata among all customers.") (emphasis added). Thus, while the UCC "permit[s] a customer to enforce its property interest against the broker-dealer, if the 'intermediary [i.e., the broker-dealer] is in insolvency proceedings and can no longer perform in accordance with ordinary Part 5 rules [i.e., the UCC duties], the applicable insolvency law will determine how the intermediary's assets are to be distributed.'" *In re Lehman Bros. Holdings Inc.*, No. 17CV3762, 2018 WL 1441407, at *7 (S.D.N.Y. Mar. 22, 2018) (citing N.Y.U.C.C. § 8-503 cmt. 2) (alteration in original); *see also SEC v. Credit Bancorp, Ltd.*, No. 99 CIV. 11395, 2000 WL 1752979, at *23−24 (S.D.N.Y. Nov. 29, 2000) (holding UCC did not allow claimants to recover stock after insolvency proceeding commenced), *aff'd*, 290 F.3d 80 (2d Cir. 2002). As the district court recently recognized, "SIPA displaces the UCC and defers to the Trustee's decisions in satisfying the unperformed duties of the broker-dealer." *In re Lehman Bros. Holdings Inc.*, 2018 WL 1441407, at *8.

Appellants claim that when the *Fishman* panel upheld certain transfers to BLMIS customers as "settlement payments" under sections 741(8) and 546(e) of the Code, it found that "each subsequent account statement issued by Madoff created an 'enforceable securities entitlement'" under the UCC. Br. 30. Not so. The *Fishman* panel <u>*never relied*</u> upon the monthly account statements in reaching its decision. Although *Fishman* cited to the UCC as support for the proposition that BLMIS customers were entitled to request withdrawals relating to securities purportedly in their account, it did not hold that Appellants are unflinchingly entitled to retain fictitious profits. Instead, as Judge Bernstein noted below, *Fishman's* "parenthetical reference to N.Y.U.C.C. § 8-501(b)(1) was made in the context of the customer's understanding that he or she was entitled to the securities identified in the monthly statement and the customer's 'intent' each time the customer requested a withdrawal 'that BLMIS dispose of securities and remit payment[s] to the customer.'" *R&R*, 2018 WL 1442312, at *13 (quoting *Fishman*, 773 F.3d at 422). Judge Bernstein correctly noted that a "customer's intent or understanding may bear on his good faith but not on value." *Id*. And good faith is not at issue here.

In any event, the UCC does not turn the brokerage relationship into a contractual agreement for the payment of a sum certain or fixed interest rate; it recognizes that a security entitlement is an interest in an asset of fluctuating value, and the risk of investment falls on the customer. Because the customer owns an interest in financial assets, not in a guaranteed dollar value or return, the customer, not the broker, bears the risk of market loss. *See, e.g., Credit Bancorp, Ltd.,* 2000 WL 1752979, at *38 n.58 (noting "the market risk assumed by each customer with respect to its underlying investment choice to purchase particular securities"); *In re Adler Coleman Clearing Corp.,* 195 B.R. at 274 (noting that SIPA customers are not protected from market loss; they are exposed "to the same risks and rewards had there been no [SIPA] liquidation. If the market goes up the customer gains, if it goes down, he loses.") (quoting 4 Collier on Bankruptcy ¶ 741.05[1] at 741−47

(Lawrence P. King et al. eds., 15th ed. 1996)); *Tangorra v. Hagan Investing Corp.*, 38 A.D.2d 671, 671, 327 N.Y.S.2d 131, 132 (N.Y. App. Div. 1971) (dismissing claim of customer against broker for value lost on security in broker's possession because "[a]ny loss plaintiff sustained was the result of her own inaction" in failing to sell).

Here, any "securities entitlement" that Appellants can claim still leaves them only with their principal investment. As Judge Rakoff recognized, Appellants would "have been entitled only to the securities in their accounts on the date of demand." *Antecedent Debt Decision*, 499 B.R. at 421 n.4. Appellants made no such demand. But even if they had, there were no securities in their accounts at any time, leaving only their principal investment as their claim under the UCC. The UCC does not provide them with securities that never existed.

Such a result accords with the panoply of decisions addressing this issue in the context of this Ponzi scheme. Courts hold that "any protectable UCC 'interest' based on the fictitious value of securities only existed for as long as the Madoff scheme remained hidden." *Jacobson Family Invs., Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 102 A.D.3d 223, 232, 955 N.Y.S.2d 338, 345 (N.Y. App. Div. 2012). They have further recognized that the "loss" of profits believed to be realized from Madoff's fraud is no loss at all. *See, e.g., Dusek v. JPMorgan Chase & Co.*, 132 F. Supp. 3d 1330, 1352–53, 1353 n.15 (M.D. Fla. 2015), *aff'd*, 832

F.3d 1243 (11th Cir. 2016). As Judge Bernstein previously recognized, courts generally find that fictitious profits were "not 'lost' to the extent they were not paid and are not recoverable as an element of damages under the UCC or in any other context in which the proposition was advanced." *Omnibus Good Faith Decision*, 531 B.R. at 465; *see also Hecht v. Andover Assocs. Mgmt. Corp.*, 114 A.D.3d 638, 641, 979 N.Y.S.2d 650, 653 (N.Y. App. Div. 2014) ("The fictitious profits never existed and, thus, Andover did not suffer any loss with respect to the fictitious sum"); *Horowitz v. Am. Int'l Grp., Inc.*, No. 09 CIV. 7312, 2010 WL 3825737, at *6 (S.D.N.Y. Sept. 30, 2010) ("Because the 'something of value' with which Madoff intended the Plaintiffs to part was their principal investment, and because the Plaintiffs recovered that principal plus an additional amount, they suffered no direct loss . . . . To the extent that they failed to recover the remaining balance of the account, that 'loss,' though direct, was not truly a loss but rather was as illusory as the initial, fraudulent gain"), *aff'd*, 498 F. App'x 51 (2d Cir. 2012). Appellants cannot claim value in a state-law interest that no court recognizes as having any value.

E. If Appellants Have Any Claims Against the Debtor, Those are Claims Against the General Estate

The Trustee does not dispute that Appellants—like all BLMIS customers—may have state law claims for damages sounding in fraud or tort against BLMIS.

But these claims are general creditor claims, and do not allow Appellants to treat fictitious profits as value.

Unlike an ordinary bankruptcy case, a SIPA liquidation preserves and protects the customer property estate in priority to the general bankruptcy estate. *See In re Weis Sec., Inc.*, No. 73 Civil 2332, 1976 WL 820, at *6−7 (S.D.N.Y. Aug. 2, 1976). Each estate has distinct characteristics and purposes. *See* SIPA § 78fff-2(c)(1); *Net Equity Decision*, 654 F.3d at 233; *Rosenman Family*, 395 F. App'x at 768. The customer property estate is composed of customer property, including recovered assets, which are earmarked to satisfy customers' net equity claims. Customers receive priority in the allocation and distribution of "customer property" and share ratably in the customer property fund. *Stafford v. Giddens*, 463 F.3d at 127.

By contrast, the general estate is made up of the debtor's assets available to satisfy the claims of general creditors. *See In re Adler Coleman Clearing Corp.*, 195 B.R. at 270. Customer property is not available to satisfy general creditors' claims unless and until all customers' net equity claims, and the other categories of obligations which customer property may be allocated under SIPA § 78fff-2(c)(1) have been fully satisfied.

In arguing that they are entitled to retain fictitious profits because the transfers satisfied alleged antecedent debts, Appellants ask this Court to ignore SIPA's priority scheme. To do so would be wrong. As Judge Rakoff explained,

> [T]he customer property estate is created as a priority estate intended to compensate customers only for their net-equity claims . . . . To the extent that [Appellants'] state and federal law claims allow them to withhold funds beyond their net-equity share of customer property, those [Appellants] are, in effect, making those damages claims against the customer property estate. Because their damages claims are not net equity claims (or any other payments that are permitted to be made in SIPA's priority scheme), allowing such claims to be drawn out of the customer property estate would violate SIPA. It is for this reason that only [an appellant's] investment of principal may count as 'value' with respect to the customer property estate for purposes of section 548(c) . . . . SIPA makes clear that net equity claims for customer property come first out of this separate estate; to the extent that payment of defendants' state and federal law claims would discharge an antecedent debt, that debt runs against Madoff Securities' general estate, not the customer property estate, and therefore cannot be the basis of the retention of customer property under section 548(c).

Antecedent Debt Decision, 499 B.R. at 424.

Judge Rakoff had it right. Appellants' state and federal law claims based on the debtor's fraud run against the general estate, as numerous decisions hold. *See, e.g., In re Klein, Maus & Shire, Inc.,* 301 B.R. 408, 421 (Bankr. S.D.N.Y. 2003) ("Because claims for damages do not involve the return of customer property entrusted to the broker they are not the claims of 'customers' under SIPA . . . . Even if it assumed that their losses were caused by fraud, breach of contract, or a similar theory, they are general creditors"); *SIPC v. Wise (In re*

Stalvey & Assocs., Inc.), 750 F.2d 464, 469 (5th Cir. 1985) (SIPA protects against particular risks associated with broker-dealer insolvencies and does not provide general insurance against investment risk or investment fraud); *In re June S. Jones Co.*, 52 B.R. 810, 814 (Bankr. D. Or. 1985) (citing *SEC v. S. J. Salmon & Co.*, 375 F. Supp. 867, 870–71 (S.D.N.Y. 1974) (claims for rescission or fraud are general claims under SIPA and are not entitled to preferred "customer status"); *SEC v. JNT Inv., Inc.*, No. 72 Civ. 681, 1978 WL 1137, at *1–2 (S.D.N.Y. Feb. 9, 1978) (customer claims for fraud, breach of contract, conversion or rescission are not "customer" claims within the meaning of SIPA). As explained in *In re MV Securities, Inc.*, the policy and primary goal of SIPA is to "protect customers who have cash and securities being held for them by a broker dealer, rather than to serve as a vehicle for litigation of claims of fraud or violations of Rule 10b-5." 48 B.R. 159, 160 (Bankr. S.D.N.Y. 1985); *see also In re Weis Sec., Inc.*, No. 73 Civil 2332, 1976 WL 817, at *2–3 (S.D.N.Y. July 29, 1976) (claims for Rule 10b-5 violations are satisfied out of general estate).

That Appellants' state and federal law claims could only run against the general estate rather than against the customer property estate is further supported by two prior decisions of this Court. The *Net Equity Decision* holds that in this liquidation, only claims for principal may be paid out of customer property; fictitious profits cannot be paid from the customer property estate. 654 F.3d at

233, 239–40; *see also SIPC v. BLMIS,* 496 B.R. 744, 759 (Bankr. S.D.N.Y. 2013), *aff'd sub nom.* 779 F.3d 74 (2d Cir. 2015); *Antecedent Debt Decision*, 499 B.R. at 424 (stating that "to the extent that payment of defendants' state and federal law claims would discharge an antecedent debt, that debt runs against Madoff Securities' general estate, not the customer property estate . . ."). The *Time-Based Damages Decision* confirms that customers are not entitled to supplement their customer claims for principal lost with amounts representing interest or inflation. *Time-Based Damages Decision*, 779 F.3d at 81. Taken together, these cases reject the notion that BLMIS customers may receive anything other than principal invested because those amounts prioritize the claims of earlier investors "at the expense of customers who have not yet recovered the property they placed in Madoff's hands." *Id.*

So here too, Appellants' claims of value in exchange for fictitious profits must be dismissed. Like those customers that unsuccessfully sought to be paid the last statement amount (net equity appeal) and interest (time-based damages appeal) as part of their net equity claim, Appellants' value defense would improperly allow claims for fictitious profits and for damages against the customer property estate. *See Antecedent Debt Decision*, 499 B.R. at 426 ("a customer may only seek the protections of section 548(c) to the extent of investments of principal, and federal and state law claims cannot be used to increase the amount to which a customer is entitled from the customer property estate").

Even more improperly, it allows Appellants to place *their* alleged tort and contract claims ahead of both the net equity claims and the general creditor claims of *other* innocent customers.[4] In essence, Appellants would be getting paid on their general estate claims *now* and from customer property, a result SIPA does not abide. *See* SIPA § 78fff-2(c)(1) (discussing waterfall provision of SIPA that holds that customer property is not available to satisfy general creditors' claims unless and until all customer net equity claims, and other categories of obligations, have been paid); *see also R&R,* 2018 WL 1442312, at *8 ("permitting a net winner to offset a non-net equity claim against the trustee's claim for the return of customer property effectively allows the net winner to recover his non-SIPA claim at the expense of net losers in violation of SIPA's priority rules.") (quoting *Cohen,* 2016 WL 1695296, at *11); *Antecedent Debt Decision*, 499 B.R. at 424, *Greiff,* 476 B.R. at 727.

Appellants seek to sidestep this fact by claiming that their fictitious profits were not "customer property" at all. In Appellants' view, there is no customer

[4] As Judge Bernstein recognized, Appellants would be getting a "dollar for dollar benefit for [their] 'claim,' while the net losers who hold net equity claims and are not fully compensated by SIPC insurance will receive less than a dollar for dollar recovery on their net equity claims." *R&R,* 2018 WL 1442312, at *7 n.17.

property until the SIPA liquidation commences and it is recovered by the Trustee. Br. 56−57 (citing *Fairfield*, 762 F.3d at 212). This is plainly wrong. Customer property is defined as "cash and securities . . . *at any time* received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted." SIPA § 78*lll*(4) (emphasis added).[5] Customer securities and cash "held by a broker on behalf of its customers is not the broker's property," *Fairfield*, 762 F.3d at 213, but customer property. *See In the Matter of Merrill Lynch, Pierce, Fenner & Smith Inc. & Merrill Lynch Prof'l Clearing Corp. Respondents*, Exchange Act Release No. 34-78141, 2016 WL 4363431, at *5 n.3 (June 23, 2016) (noting that customer cash and securities are not assets of the broker-dealer but are held by the broker in a "custodial capacity . . . designed to ensure that the carrying broker-dealer treats them in a manner that allows for their prompt return.").

Since Appellants have stipulated that (i) they transferred money to BLMIS for the purchase of securities; (ii) BLMIS used commingled customer money to fund the withdrawal of fictitious profits by customers, like Appellants; and (iii)

[5] In addition to the plain statutory text, "customer property" is a term of art in the securities industry, which is used regularly to refer to property held by a broker-dealer but belongs to customers. *See* Michael P. Jamroz, *The Customer Protection Rule*, 57 Bus. Law. 1069, 1071−74 (2002).

BLMIS had no sources of funds other than customer monies to pay withdrawals, *see* South Ferry Stip. ¶¶ 12−15, 24, 31; Lowrey Stip. ¶¶ 12−15, 21, 29, 37, 47; Mesora Stip. ¶¶ 12−15, 25, 33; SF #2 Stip. ¶¶ 12−15, 24, 31, there is no question that the transfers at issue here were customer property. In any event, this Court recently rejected Appellants' argument that customer property only comes into being upon the commencement of the liquidation, finding that customer property can be transferred "prior to the formation of a liquidation estate." *In re Picard*, 917 F.3d 85, 92 (2d Cir. 2019).

As to whether *Fairfield* requires property to be recovered before it becomes "customer property" under SIPA, the answer is no. First, that decision did not address the definition of customer property. Second, the statutory definition of customer property includes property "unlawfully converted"—like the property here that was unlawfully converted by BLMIS and improperly transferred to other customers. Third, if the only "customer property" in a case were property already in the Trustee's possession, SIPA trustees would never need to bring an avoidance action under SIPA § 78fff-2(c)(3), nor could they. Section 78fff-2(c)(3) of SIPA provides that a trustee "may recover any property transferred by the debtor which, except for such transfer, *would have been* customer property…." SIPA § 78fff–2(c)(3) (emphasis added); *In re Picard*, 917 F.3d at 94−95 (describing SIPA and Bankruptcy Code avoidance provisions that permit trustee to recover customer property). Had BLMIS *not* transferred the money to Appellants then the money *would have been* customer property, so the statute plainly reaches it. *See also Trefny v. Bear Stearns Sec. Corp.*, 243 B.R. 300, 322 (S.D. Tex. 1999) (the purpose of SIPA section 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"). Quite simply, *Fairfield* "does not limit the ability of a trustee in any liquidation to recover intentionally fraudulent transfers such as those at issue here." *Summary Judgment Decision*, 596 B.R. at 468.

F. The Meaning of "Value" Has Not Changed

Finding no support in either the Bankruptcy Code or SIPA for their argument that fictitious profits constitute value, Appellants posit that "the term 'value' is not meant as a term used in ordinary parlance: *i.e.*, as a measure of worth." Br. 25.

But this Court long ago rejected Appellants' view by interpreting the fraudulent conveyance provisions of the former Bankruptcy Act and New York Debtor and Creditor Law ("DCL") §§ 270–281 to incorporate a requirement that the repaid debt be "substantially equivalent in value to the property given." *Rubin v. Mfrs. Hanover Tr. Co.*, 661 F.2d 979, 991 (2d Cir. 1981) (citing Bankruptcy Act § 67(d)(1)(e)); *see also HBE Leasing Corp.*, 48 F.3d at 638 (requiring "fair consideration" under DCL § 272); *In re Sharp Int'l Corp.*, 403 F.3d 43, 53 (2d Cir. 2005) (same).[6] Others have applied the same test to section 548(c) itself. *See, e.g.*, *Perkins v. Haines*, 661 F.3d 623, 627–28 (11th Cir. 2011); *In re Wes Dor, Inc.*, 996 F.2d 237, 243 (10th Cir. 1993); *In re Actrade Fin. Techs. Ltd.*, 337 B.R. 791, 803 (Bankr. S.D.N.Y. 2005); *In re Countdown of Conn., Inc.*, 115 B.R. 18, 21 (Bankr. D. Conn. 1990); *Sender v. C & R Co.*, 149 B.R. 941, 947 (D. Colo. 1992).

These cases correctly interpret the statutory text. Appellants concede that their reading of the term "value" departs from "ordinary parlance," Br. 25, which is a good reason to reject it: it is elementary "that the ordinary meaning of [the] language accurately expresses the legislative purpose." *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 251 (2010). The term "value" means "[a] fair return in money, goods, services, etc., for something exchanged" and "that which is considered an equivalent in worth." Webster's New Int'l Dictionary 2814 (2d ed. 1957). The statute calls for a comparative inquiry into what was exchanged for what and how much each was worth. *See, e.g., In re Roosevelt*, 220 F.3d 1032, 1039 (9th Cir. 2000) (finding that exchange of property "is not the end of the inquiry," as transferee "bears the burden of proving the value she gave"); *Hays v.*

[6] Appellants rely heavily (but erroneously) on *In re Sharp International Corp.*, 403 F.3d at 53, and thus cannot credibly claim a meaningful difference between DCL § 272 and section 548(c) of the Bankruptcy Code.

Jimmy Swaggart Ministries, 263 B.R. 203, 211 (M.D. La. 1999) (identical approach).

The text in no way signals that, in protecting exchanges made "for value," 11 U.S.C. § 548(c), Congress meant to include transfers of large sums in return for nothing. This runs afoul of both the absurd-results canon, *see SEC v. Rosenthal*, 650 F.3d 156, 162 (2d Cir. 2011), and Circuit precedent, *Rubin*, 661 F.2d at 991. Thus, payments that exceed the value of any colorable debt satisfaction, like those challenged here, do not qualify as "value."

Once again, no case law supports Appellants' position. They rely on *In re Sharp International Corp.*, 403 F.3d at 54, but it expressly holds that, to qualify for the defense, the satisfaction of debt "must be a 'fair equivalent' of the property received." *Id.* at 53. Appellants cite the outcome favorable to the defendant in *Sharp*, but the case turned on the good-faith prong, not the value prong. The Court did not need to address the latter because the trustee in that case "acknowledge[d] that the payment at issue discharged an antecedent debt *and was made for 'fair equivalent.*'" *Id.* at 54 (emphasis added). There is no such concession here, nor would one be tenable.

Appellants' reliance on *Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504 (1st Cir. 1987) is also misplaced. Judge Breyer's decision there expressly held that a fraudulent conveyance occurs where a transferee "did not give 'fair consideration' (defined . . . as a 'fair equivalent'. . .)." 835 F.2d at 1510. Appellants are correct that *Boston Trading Group* concluded that repaying one creditor over another is not a fraudulent conveyance under state law. *Id.* at 1508–09. But it does not follow that *profit* payouts that constitute the investments of other victims fall within this paradigm; they are, rather, the act of fraud itself. *Boston Trading* was not a Ponzi-scheme case, and subsequent Ponzi-scheme cases found its holding inapplicable in this context. *See, e.g., In re Int'l Mfg. Grp., Inc.*, 538 B.R. 22, 26–27 (Bankr. E.D. Cal. 2015); *In re Petters Co., Inc.*, 499 B.R. 342, 349–52 (Bankr. D. Minn. 2013).

Besides, *Boston Trading* disclaimed Appellants' view that a debt payment far in excess of its true value enjoys this protected status and remanded for an assessment of whether the debt payment was worth the debt extinguished. 835 F.2d at 1513. As Judge Breyer explained, "'[t]he fair equivalent' question in respect to the settlement of the state court lawsuit is whether the settlement was worth the $400,000 [the debtors] paid for it." *Id.* That is the inquiry the district court conducted, and that Appellants say it should *not* have conducted. As described, Appellants' profits were in excess of the true value of any cognizable legal claims. *Boston Trading* rejects Appellants' position that they are entitled to them irrespective of the actual worth of those claims.

The Bankruptcy Code, SIPA, and all case law supports the Trustee's position that there is no value exchanged for fictitious profits. The district court was correct to reject Appellants' value defense under section 548(c), and this Court should as well.

II. THE TRANSFERS AVOIDED ALL OCCURRED WITHIN THE LIMITATIONS PERIOD

The district court's judgment avoiding the transfers sought by the Trustee was correctly entered. The Trustee properly calculated Appellants' avoidance liability using the net investment method prescribed by this Court's *Net Equity Decision* combined with the two-step process endorsed by courts across the nation when calculating fraudulent transfer liability stemming from a Ponzi scheme. The transfers sought by the Trustee each took place no more than two years before the liquidation commenced, consistent with the statutory limits of section 548(a)(1)(A). Appellants' arguments to the contrary are wrong.

A. The Trustee Properly Calculated Appellants' Avoidance Liability

As set forth in *Greiff,* the *Antecedent Debt Decision*, and this Court's *Net Equity Decision*, the Trustee's properly calculated Appellants' avoidance liability by looking at the entirety of Appellants' account histories and netting the deposits and withdrawals.

To quantify what portion of a transfer consists of principal and what portion consists of fictitious profits, a trustee must look to the entire investment relationship to determine at what point a customer's withdrawals exceeded their principal investment. While the law may restrict avoidance of transfers that occurred within a certain time period, *see, e.g.*, section 546(e), determining the quantum of fraudulent transfers requires consideration of the entire transactional history. *See In re Nat'l Liquidators, Inc.*, 232 B.R. 915, 918−20 (Bankr. S.D. Ohio 1998); *In re Lake States Commodities, Inc.*, 253 B.R. at 871.

Judge Rakoff correctly described the approach as follows:

> As for the calculation of how much the Trustee may recover under [section 548(a)(1)(A)], the Court adopts the two-step approach set forth in *Donell v. Kowell*, 533 F.3d 762, 771−72 (9th Cir. 2008). First, amounts transferred to Madoff Securities to a given defendant at any time are netted against the amounts invested by that defendant in Madoff Securities at any time. Second, if the amount transferred to the defendant exceeds the amount invested, the Trustee may recover these net profits from that defendant to the extent that such monies were transferred to that defendant in the two years prior to Madoff Securities' filing for bankruptcy.

Greiff, 476 B.R. at 729.

This Court implicitly endorsed this approach, stating that "in the context of *this* Ponzi scheme—the Net Investment Method is nonetheless more harmonious with provisions of the Bankruptcy Code that allow a trustee to avoid transfers made with the intent to defraud and 'avoid[s] placing some claims unfairly ahead of others.'" *Net Equity Decision*, 654 F.3d at 241 n.10 (alteration in original) (citation omitted) (quoting *In re Adler Coleman Clearing Corp.*, 263 B.R. at 463).

Moreover, applying the net investment method to determine both net equity claims and the amount of avoidable transfers recoverable by the Trustee ensures that customers get the benefit of all deposits they made over the course of their relationship with BLMIS, whether they are "net losers" or "net winners." Any other method of calculating the amount of principal lost would arbitrarily alter the net equity position of some customers at the expense of others in violation of the *Net Equity Decision*. As Judge Rakoff observed, it "makes little sense to draw a boundary at the beginning of the reach-back period for purposes of recovery but not for purposes of net-equity claims." *Antecedent Debt Decision*, 499 B.R. at 427 (citing *Donell*, 533 F.3d at 773−74).

For these reasons, Judge Rakoff correctly rejected the arguments made by Appellants here that the calculation of avoidance liability should begin anew at the outset of the two-year period:

> It is true that section 548(a)(1) allows the Trustee to avoid only those transfers made by the debtor "on or within 2 years of the filing of the petition." 11 U.S.C. § 548(a)(1)(A). Yet there is no similar limitation in section 548(c) with respect to whether a given transfer is "for value." The concept of harm or benefit to the estate is separate from the concept of the reach-back period, which merely serves to allow finality to ancient transactions . . . . Thus, there is no reason why a line should be drawn at the beginning of the reach-back period in determining whether a transfer was for value . . . . Just as defendants are entitled to net-equity claims for amounts of principal invested before the reach-back period they never withdrew, so too must withdrawals before the reach-back period be considered to determine whether a given transfer in fact compensated a given defendant for a claim it would have otherwise have had.

Antecedent Debt Decision, 499 B.R. at 427.

No authority changes this result. The Supreme Court's decision in *California Public Employees Retirement System v. ANZ Securities, Inc.* 137 S. Ct. 2042 (2017), in which the Court considered whether the three-year period within which claims must be brought under section 11 of the Securities Act of 1933 was a statute of limitations or statute of repose, is inapposite. As the district court held, Appellants' reliance on this case is misplaced because the analysis in the *Antecedent Debt Decision* regarding the calculation of avoidance liability "did not turn on whether § 546(a) was a statute of repose or a statute of limitation." *Summary Judgment Decision*, 596 B.R. at 471−72 (citing *Antecedent Debt Decision*, 499 B.R. at 427). Instead, it focused on the concept of harm or benefit to the estate being distinct from the concept of a reach-back period. *Id.*

B. The Trustee Properly Seeks Transfers Within the Two-Year Period

The Bankruptcy Code provides that the "trustee may avoid any transfer . . . of an interest of the debtor in property, or any obligation . . . incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition . . . ." 11 U.S.C. § 548(a)(1). The parties stipulated that the Trustee sustained his *prima facie* case to avoid transfers to Appellants made within the two-year period preceding the liquidation. *See* South Ferry Stip. ¶ 28 ("BLMIS transferred the funds withdrawn by the Defendants during the Two-Year Period with the actual intent to hinder, delay, or defraud some or all of its existing and/or future creditors."); Lowrey Stip. ¶ 44 (same); Mesora Stip. ¶ 30 (same); SF #2 Stip. ¶ 28 (same).

Lacking any real defenses, Appellants offer a contorted argument that the Trustee cannot avoid the transfers made within the two-year period because the purported obligation arose prior to that time. Br. 43. Although Judge Engelmayer did not address this argument, Judge Rakoff rejected it. *Greiff*, 476 B.R. 715. And this Court can safely ignore it. The statute is disjunctive: "the trustee may avoid any transfer . . . *or* any obligation . . . that was made *or* incurred on or within 2 years . . . ." 11 U.S.C. § 548(a)(1) (emphasis added). By its terms, the Code does not require the Trustee to avoid an obligation to avoid a transfer.

Thus, the Trustee can avoid the transfer, whether or not any "obligation" existed outside the two-year limitations period, because all transfers are within that period, as Appellants so stipulated. *In re Omega Door Co., Inc.*, 399 B.R. 295, 304 (B.A.P. 6th Cir. 2009) (holding that two-year limitation period "did not bar the recovery of installment payments even though the underlying obligation that gave rise to the payments would be barred from avoidance"); *In re TransTexas Gas Corp.*, 597 F.3d 298, 305 (5th Cir. 2010) (reading this disjunctive provision to apply "either at the time of the transfer of funds or at the time the [debtor] incurred such obligation"); *In re Advanced Telecomm. Network, Inc.*, 490 F.3d at 1332 (same under identically worded state law). The plain language defeats Appellants' position.

So do their own cases. They rely on *In re Tribune Co. Fraudulent Conveyance Litigation*, No. 11-MD-2296, 2018 WL 6329139, at *12 (S.D.N.Y. Nov. 30, 2018), *reconsideration denied*, No. 11-MD-2296, 2019 WL 549380 (S.D.N.Y. Feb. 12, 2019), and are correct that it held that obligations incurred outside the two-year period could not be avoided. Br. 44−45. But they ignore the discussion of transfers: "Of course, the Trustee also seeks to avoid the actual . . . [t]ransfers themselves, which were indisputably made during the two-year window." *In re Tribune Co. Fraudulent Conveyance Litig.*, at *16. The court went on to consider these claims on the merits, since the limitations period did not bar them. *See id.* at *16–17. Meanwhile, in a subsequent opinion, *In re Tribune Co. Fraudulent Conveyance Litigation*, No. 11-MD-2296, 2019 WL 294807, at *21 (S.D.N.Y. Jan. 23, 2019), there was no transfer, so the only relevant thing to be avoided was the obligation. Here, the transfers can be avoided, as the statute so directs. That resolves the issue.

CONCLUSION

The Court should affirm the district court's judgment.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 11,648 words, excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii). This brief complies with the requirements of Fed. R. App. P. 32(a)(5) and (6) because it has been prepared in a Times New Roman 14-point proportionally spaced font.

/s/ *Seanna R. Brown*
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CERTIFICATE OF SERVICE

I hereby certify that on September 3, 2019, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Second Circuit by using the appellate CM/ECF system. I further certify that I will cause six paper copies of this brief to be filed with the Court. The participants in the case are registered CM/ECF users, and service will be accomplished by the appellate CM/ECF system.

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