Bloomberg

September 7, 2011 | bloomberg.com

News

Madoff: Bankruptcy

Sept. 7 (Bloomberg) — The trustee liquidating Bernard L. Madoff Investment Securities Inc. received a vote of confidence last week when U.S. District Judge Kimba M. Wood ruled that he is using valid theories to recover money customers took out of the Ponzi scheme before the fraud was discovered.

Although Wood's ruling was made in a different case, it throws cold water on an effort by the owners of the New York Mets baseball club to win dismissal of a similar lawsuit where the Madoff trustee is demanding $1 billion.

Last year, the bankruptcy court turned back an effort by the Ariel and Gabriel funds controlled by Ezra Merkin to dismiss the trustee's complaint to recover $34 million taken out before the Madoff fraud surfaced. Taking the facts in the complaint as true, Wood said that the trustee's case passes muster at the early stages of a lawsuit.

In one of several rulings equally applicable to the trustee's $1 billion lawsuit against Fred Wilpon; Sterling Equities Inc., the Mets' owners; and Wilpon's friends, family and associates, Wood said in her Aug. 31 opinion that it was sufficient if only Madoff, not the customer, had an intent to defraud under both federal and state law.

While Merkin claimed he acted in good faith and therefore had a valid affirmative defense, Wood said the defense can't ordinarily be raised when attacking a complaint at the early stage of a case, before discovery is completed.

Wood also said that a defrauded customer's claim against the broker doesn't constitute "value" to offset a fraud claim.

Like Wilpon, Merkin contended that he is protected from suit by Section 546(e) of the Bankruptcy Code, known as the safe harbor. To fall within the safe harbor, the Madoff firm must have made the payment as a "stockbroker," Wood said. The judge could find no authority for the proposition that a Ponzi scheme operator qualifies as a stockbroker when no actual trades in securities were ever made.

Wilpon and the Mets' owners are asking a different U.S. District Judge, Jed Rakoff, to dismiss the Madoff trustee's suit on many of the same grounds. Although Rakoff isn't bound by Wood's decision, it would be an unusual and potentially embarrassing result if two equally ranked district judges in the same courthouse reached differing conclusions.

Merkin ended up in Wood's court after the bankruptcy judge last year denied his motion to dismiss the suit. Wood issued her decision in response to Merkin's motion for what's known as an interlocutory appeal, or an appeal taken before the case is finished entirely.

Interim orders, such as denial of a motion to dismiss, ordinarily aren't appealable in federal courts. Wood said there wasn't sufficient difference of opinion about the bankruptcy judge's ruling to justify allowing Merkin to take a premature appeal.

The Madoff firm began liquidating in December 2008, with the appointment of the trustee under the Securities Investor Protection Act. Bernard Madoff individually went into an involuntary Chapter 7 liquidation in April 2009. His bankruptcy case was consolidated with the firm's liquidation.

Madoff is serving a 150-year prison sentence following a guilty plea.

Merkin's attempted appeal in district court is Picard v. Merkin (In re Bernard L. Madoff Investment Securities LLC), 11-mc-00012, U.S. District Court, Southern District of New York (Manhattan).

The liquidation in bankruptcy court in the Madoff liquidation case is Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities Inc., 08-01789, U.S. Bankruptcy Court, Southern District of New York (Manhattan). The criminal case is U.S. v. Madoff, 09-cr-00213, U.S. District Court, Southern District of New York (Manhattan).

By Bill Rochelle