Securities Regulation Daily Wrap Up, TOP STORY—U.S.: Madoff trustee seeks review of decision preventing claw back of investor withdrawals, (Mar. 18, 2015)

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By Amy Leisinger, J.D.

Madoff trustee Irving Picard has petitioned the Supreme Court to review a Second Circuit decision affirming a ruling preventing a "claw back" of money paid out to investors requesting withdrawals from Bernard L. Madoff Investment Securities LLC (BLMIS) prior to the discovery of Madoff's massive Ponzi scheme. According to the petition, the Second Circuit improperly found that the transfers to customers constituted payments made in connection with securities contracts or settlement payments that, under Sec. 546(e) of the Bankruptcy Code, cannot be avoided in bankruptcy proceedings. The court failed to interpret the statute according to its plain meaning and in proper context, the petition argues, and unnecessarily created a conflict between congressional powers (*Picard v. Ida Fishman Revocable Trust*, [14-1128], and [14-1129], March 17, 2015).

The Securities Investor Protection Corporation (SIPC) joined the trustee in filing the petition, and, in a press release, SIPC President Stephen Harbeck said: "SIPC believes that the trustee has the authority, as a matter of law, to recover certain payments made by Madoff to customers, when no actual securities transactions ever took place. The correct interpretation of the Bankruptcy Code and the Securities Investor Protection Act would allow the trustee to do the greatest good for the greatest number of Madoff's victims."

Background. Following the collapse of BLMIS' Ponzi scheme, Irving H. Picard was appointed trustee for BLMIS and, under the Securities Investor Protection Act (SIPA), was empowered to recover money paid out by the company in transactions voidable under the Bankruptcy Code. The trustee sought to claw back money from customers who, over time, were able to take out more than they had invested with BLMIS. Several of these customers moved to dismiss the action, claiming protection under Bankruptcy Code Sec. 546(e), which provides that certain securities-related payments, such as transfers made by a stockbroker "in connection with a securities contract" or "settlement payments," cannot be avoided in bankruptcy. The Southern District of New York concluded that the payments to BLMIS to customer were in fact shielded by this provision and dismissed the relevant claims.

The Second Circuit agreed, noting in its opinion (covered in the *Securities Regulation Daily Wrap Up* for December 8, 2014) that, under the Bankruptcy Code, the definition of "securities contract" is broad and "expansively includes contracts for the purchase or sale of securities, as well as any agreements that are similar or related to contracts for the purchase or sale of securities." At a minimum, the court found, the account documents involved agreements "similar to" purchase and sales contracts, which are also protected under Sec.546(e). BLMIS' fraudulent activities do not negate the existence of the contracts with customers in the first instance, the court found, and the customers' subsequent withdrawals were related to a securities contract. The court also rejected the trustee's contention that the transfers did not constitute settlement payments because BLMIS never engaged in actual trading; BLMIS had discretion to liquidate securities to the extent necessary to fulfill withdrawal requests and each transfer in respect of a request constituted a settlement payment, the court reasoned.

Petition for certiorari. The petition asks the court to consider whether Sec. 546(e) applies to protect payments involving fictitious securities transactions and whether such an application is inconsistent with SIPA. The petition argues that the Second Circuit erroneously concluded that original account documents constituted "securities contracts" not subject to avoidance because there were never any financial market transactions. According to the petition, legislative history demonstrates that Congress did not intend for the definitions to "sweep so broadly," and other courts have recognized held the Sec. 546(e) does not even apply to Ponzi scheme bankruptcies. "[C]ourts should be reluctant to withdraw such [avoidance] powers unless 'clearly and manifestly' within the intent of Congress," the petition states.

SIPA provides trustees with the authority to avoid fraudulent transfers to provide a means by which customers can recover their rightful property, the petition explains, and the Second Circuit's decision protects securities policies at the expense of bankruptcy protections for broker customers. Moreover, the petition argues that preventing clawback by use of Sec. 546(e) results in inequitable treatment of investors, benefitting earlier investors at the expense of the many. To insulate the earlier transfers from avoidance "creates inequity between and among creditors while perpetuating and giving life and legitimacy to the fraud that gave rise to the inequity in the first place," the petition concludes.

The cases are Nos. 14-1128 and 14-1129.

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Companies: Bernard L. Madoff Investment Securities LLC

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