12-2557-bk(L)

12-2497-bk(CON), 12-2500-bk(CON), 12-2557-bk(CON), 12-2616-bk(CON), 12-3422-bk(CON), 12-3440-bk(CON), 12-3582-bk(CON), 12-3585-bk(CON)

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

IN RE: BERNARD L. MADOFF INVESTMENT SECURITIES LLC,
Debtor.

IRVING H. PICARD, Trustee for the Liquidation of
Bernard L. Madoff Investment Securities LLC,
Plaintiff-Appellant,

SECURITIES INVESTOR PROTECTION CORPORATION, Statutory Intervenor pursuant to
Securities Investor Protection Act, 15 U.S.C. § 78eee(d),
Intervenor-Appellant,

v.

IDA FISHMAN REVOCABLE TRUST, PAUL S. SHURMAN,
in his capacity as co-trustee of the Ida Fishman Revocable Trust,
WILLIAM SHURMAN, in his capacity as co-trustee of the Ida Fishman Revocable
Trust and as Executor of the estate of Ida Fishman,
Defendants-Appellees.

On Appeal from the United States District Court for the
Southern District of New York, Before the Honorable Jed S. Rakoff

BRIEF FOR AMICUS CURIAE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF DEFENDANTS-APPELLEES AND AFFIRMANCE

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, the undersigned counsel certify that the Securities Industry and Financial Markets Association ("SIFMA") has no parent company and that no publicly held company owns more than 10% of SIFMA.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES AND LEGISLATIVE MATERIALS

OTHER AUTHORITIES

INTEREST OF AMICUS CURIAE

The Securities Industry and Financial Markets Association ("SIFMA") consists of hundreds of securities firms, broker-dealers, banks, and asset managers of all sizes.[1] SIFMA's members share a common interest in maintaining a robust, stable securities market and in protecting investor confidence in that market, particularly when a broker-dealer becomes insolvent. The proper interpretation and enforcement of both the Securities Investor Protection Act ("SIPA") and the Bankruptcy Code's safe-harbor provision for securities transactions, 11 U.S.C. §546(e), are thus of particular importance to SIFMA. In this case, the two go hand in hand. Contrary to the Trustee's contentions, the faithful application of §546(e) according to its terms is fully consistent with—indeed, it is essential to—SIPA's purpose of protecting investors and promoting investor confidence in the securities market.

PRELIMINARY STATEMENT

The liquidation of Bernard L. Madoff Investment Securities Inc. ("Madoff") has raised many difficult issues. Madoff's fraud devastated thousands of investors, and now that Madoff is bankrupt, some of those investors may never fully recoup all of their losses. The process of distributing Madoff's remaining assets has been

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than amicus, its members, or its counsel made any monetary contribution toward the preparation or submission of this brief. The parties have consented to the filing of this brief.

complex and has left many investors dissatisfied with their recovery. Allowing some investors to retain funds they withdrew from their Madoff accounts may limit how much can be distributed to other investors. But, as this Court has recognized in other Madoff-related appeals, different investors have different views of what is equitable, and in any event, equitable concerns cannot override the law.

This appeal turns on that fundamental point. The trustee in Madoff's insolvency proceeding under the Bankruptcy Code and SIPA seeks to recover from thousands of investors the distributions they received from Madoff before its fraud was revealed. Those investors entered into agreements with Madoff under which it would purchase and sell securities for the investors' accounts, and they would be entitled to withdraw the proceeds. But, unbeknownst to the investors, Madoff breached the agreements and did not buy or sell securities for their accounts. The Trustee argues that allowing these investors to keep the funds they withdrew from their securities accounts would be inequitable because it would prejudice the recovery of other investors. But the Trustee's view of equity cannot trump the plain language of §546(e) of the Bankruptcy Code and the policy judgments that Congress made in enacting that safe harbor for securities transactions.

Congress enacted §546(e) to balance the competing policies of bankruptcy and securities law. Under §546(e)'s safe harbor, transfers made in connection with securities contracts—like the withdrawals at issue here—may not be avoided as fraudulent conveyances or preferences, with the sole exception of actually fraudulent transfers made not more than two years before the bankruptcy. The Trustee nonetheless seeks to claw back transfers to investors falling outside that narrow exception. Specifically, he seeks to recover (1) payments to so-called "net winners"—investors who withdrew more from their accounts than they deposited—made before the two-year look-back period for federal fraudulent-transfer actions, and (2) payments to so-called "net losers" made within the ninety-day preference period prior to the bankruptcy filing. Those payments are shielded from recovery by §546(e)'s safe harbor. A contrary ruling would destabilize the securities markets and undermine Congress's careful judgment in crafting the safe harbor.

SUMMARY OF ARGUMENT

I. A. The Trustee and the Securities Investor Protection Corporation ("SIPC") wrongly argue that §546(e) is not applicable here because Madoff—while purporting to do so—never actually bought or sold securities. The premise of that argument—that §546(e)'s sole purpose is to prevent the unwinding of completed securities transactions—ignores the words of the statute, as well as the settled law of this Circuit. Although the safe harbor certainly protects the finality of settled securities transactions, that is not its only goal. Rather, it plays a broader—and critical—role in protecting a vibrant and liquid securities market.

The statute's text itself makes that plain: By its terms, §546(e) protects not only "settlement payments" made to complete a securities transaction, but also any other payments made "in connection with a securities contract." Section 546(e) thus serves to promote investor confidence in the securities markets. It ensures that a broker's bankruptcy will not force investors to surrender funds they withdrew from their accounts in good faith, pursuant to agreements with their broker for the purchase and sale of securities. That goal applies equally where, as here, the broker breached those agreements and never actually bought or sold securities for investors' accounts. Construing the safe-harbor provision to exclude the investors here from its protections would defeat Congress's aim of promoting confidence in the securities markets.

I. B. Madoff's contracts with its customers were conventional investment agreements pursuant to which Madoff agreed to purchase and sell securities on its customers' behalf. These were enforceable agreements as a matter of black-letter contract law, and they were "securities contracts" within the plain meaning of the Bankruptcy Code. That Madoff lied to its customers and never actually bought or sold any securities does not change the enforceability or nature of the agreements. Nor, contrary to the Trustee's contentions, does it matter that the agreements (1) were between a broker-dealer and its customers, rather than between a buyer and seller of securities, or (2) provided for discretionary trading, rather than the purchase or sale of a specified security. Were either of these two circumstances to render §546(e) inapplicable, the safe-harbor provision would fail in its purpose, as the universe of managed investment accounts—a multi-trillion dollar industry in today's securities markets—would be unprotected.

II. The Trustee and SIPC's construction of the safe-harbor provision would undermine the modern, efficient methods of securities trading that SIPC itself argues drove Congress's decision to enact and expand §546(e). If the Trustee's theory is adopted, investors who wish to ensure that they are protected by §546(e) will have to obtain physical proof that their broker bought securities for them by demanding that the broker send them paper certificates, rather than permitting the broker to hold securities for their accounts in the broker's name, as is the norm in the modern securities industry. As the country emerges from the recent financial crisis, it is crucial to continue to enforce the Code's safe harbors as they were written and thus protect the securities markets from the loss of faith and disarray that the safe harbors were intended to prevent.

ARGUMENT

I. SECTION 546(e) BARS THE TRUSTEE'S CLAIMS HERE

A. Congress Enacted And Expanded §546(e) To Promote Confidence And Stability In The Securities Markets

The Trustee's and SIPC's arguments for reversal start from a faulty premise—that Congress's sole goal in enacting §546(e) was to protect the unwinding of settled securities trades and that, therefore, the safe harbor has no applicability where a broker-dealer lies to its clients and fails to buy or sell securities for their accounts. *See, e.g.*, Trustee Br. 25; SIPC Br. 40. The purpose of §546(e) is far broader—to promote investor confidence in the securities markets—and that purpose would be undermined if a bankruptcy trustee could recover withdrawals by investors from their securities accounts going back many years simply because, unbeknownst to the investors, their securities firm was operating a Ponzi scheme.

As this Court recently noted, §546(e) "stands 'at the intersection of two important national legislative policies on a collision course—the policies of bankruptcy and securities law.'" *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329, 334 (2d Cir. 2011). In ordinary circumstances, bankruptcy law accords a trustee (including a SIPA trustee, *see* 15 U.S.C. §78fff-1(a)) broad powers to unwind prepetition transfers for the benefit of the debtor's creditors. *See In re Housecraft Indus. USA, Inc.*, 310 F.3d 64, 71 (2d Cir. 2002). The statutory safe harbor, however, provides a necessary check on these powers where they could otherwise frustrate important national policies concerning the securities markets.

Where the safe harbors do not apply, a bankruptcy trustee may avoid two distinct kinds of transfers. *First*, under fraudulent-transfer law, a trustee may avoid transfers by a debtor that deprive its creditors of assets that could otherwise pay their claims. Such transfers may be actually fraudulent—that is, made with an actual intent to hinder, delay, or defraud—or "constructively fraudulent"—that is, made by an insolvent debtor for less than reasonably equivalent value. The Code provides the trustee with a federal cause of action to avoid fraudulent transfers made within two years of the bankruptcy filing, 11 U.S.C. §548(a)(1)(A)-(B); *id.* §546(a), and also permits him to avoid transfers that would be avoidable by creditors under applicable state law, which often has much longer look-back periods, *id.* §544. *Second*, a trustee can avoid as a preference an insolvent debtor's payment to a creditor in satisfaction of a debt made during the ninety days preceding bankruptcy, if the transfer enabled the creditor to receive more than it otherwise would have received in the bankruptcy proceedings. *Id.* §547(b).

To protect the securities markets, §546(e) excepts most securities transactions from the trustee's broad avoidance powers under §§544, 547, and 548(a)(1)(B). Section 546(e) provides in relevant part:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer [1] that is a … settlement payment … , made by or to (or for the benefit of) a … stockbroker … or [2] that is a transfer made by or to (or for the benefit of) a … stockbroker … in connection with a securities contract, … that is made before the commencement of the case, except under section 548(a)(1)(A)[.]

In other words, Congress permitted bankruptcy trustees to avoid under §548(a)(1)(A) settlement payments and other transfers made in connection with securities contracts if they are actually fraudulent and made within two years before the bankruptcy filing, but otherwise barred fraudulent-transfer and preference claims seeking to undo such transfers. Congress struck this balance to ensure stability and promote investor confidence in the securities markets. *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 986-987 (8th Cir. 2009).

Contrary to the Trustee's cramped reading of the statute, the focus of the safe harbor is not a particular type of transaction or method of transacting but, more broadly, "transactions involving financial markets." *See* S. Rep. No. 95-989, at 8 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5794 (the safe harbor's purpose is to "promote customer confidence in commodity markets generally" and to provide for "the protection of commodity market stability"); H.R. Rep. No. 101-484, at 2 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 224; *see also* S. Rep. No. 101-285, pt. III (1990) (forward contract provisions protect markets); S. Rep. No. 98-65, at 48-49 (1983) (amendments intended to "minimize the displacement" in "markets"). As Congress reiterated as recently as in 2006, §546(e) is intended to "reduce *systemic risk*." H.R. Rep. No. 109-648, at 1-2 (2006) (emphasis added).

Notably, Congress has revisited §546(e) on several occasions and has repeatedly reaffirmed its determination to balance the Nation's securities and bankruptcy laws in this way. *Picard v. Katz*, 462 B.R. 447, 452 n.3 (S.D.N.Y. 2011). Indeed, since the safe harbor's enactment in 1978, Congress has amended it to expand its scope to accommodate and protect evolving markets. *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 849 (10th Cir. 1990); Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 109 Stat. 105 (expanding §546(e) to cover "financial participants" and creating additional safe harbor for master netting agreements); H.R. Rep. No. 109-648, at 8 (2006) (broadening scope to include transfers made "in connection with a securities contract").

This Court has recognized the breadth of §546(e). Noting Congress's goal of broadly protecting the securities markets, it has explained that Congress enacted the provision "as a means of minimizing the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." *Enron*, 651 F.3d at 334 (internal quotation marks and brackets omitted). This Court has rejected interpretations of §546(e)—such as the Trustee's—that would "result in commercial uncertainty and unpredictability at odds with the safe harbor's purpose and in an area of law where certainty and predictability are at a premium." *Id.* at 336.

In short, the purpose of the safe harbor is to protect entire markets and industries from the destabilizing effects of major bankruptcies and not simply, as the Trustee and SIPC contend, to protect a securities firm from the unwinding of a particular settled transaction. For §546(e) to serve its intended purpose—to ensure finality and stability in financial markets—the statute must be enforced as written. *Enron*, 651 F.3d at 339; *In re MBS Mgmt. Servs., Inc.*, 690 F.3d 352, 355 (5th Cir. 2012). As the district court observed below, the narrow reading of the safe harbor the Trustee advocates would undermine this central objective of §546(e)—and that is particularly so on the facts of this case: "Although the Trustee argues that avoiding Madoff Securities' transfers to customers cannot cause the 'displacement' that §546(e) aims to prevent, this seems at variance with his own Amended Complaint, which alleges that the Madoff fraud involved approximately $68 billion and 4,900 customers." *Katz*, 462 B.R. at 452.

The need for clarity and the security that §546(e) is meant to provide is paramount here because, while Madoff's fraud was extraordinary, the agreements between Madoff and its investors were commonplace. Managed accounts like those Madoff purported to maintain for its customers are a multi-trillion dollar industry.[2] Under such arrangements, which are governed by standard industry agreements like those between Madoff and its customers, investors deposit funds with a broker and can withdraw those funds at any time; the manager has broad

[2] *See* SEC, *Study on Investment Advisers and Broker-Dealers* 6-7 (Jan. 2011), *available at* www.sec.gov/news/studies/2011/913studyfinal.pdf.

discretion as to which securities to purchase and, when a client seeks to withdraw funds, which to sell. Investors need assurance that withdrawals they make from their brokerage accounts, pursuant to such standard agreements, will not be avoidable (unless they are intentionally fraudulent under §548(a)(1)(A)) in the event of their broker-dealer's insolvency. *Cf. SEC v. Zandford*, 535 U.S. 813, 822-823 (2002) (A broker's fraudulent practice of selling customer's securities with the undisclosed intent to misappropriate the proceeds "[n]ot only … prevent[s] investors from trusting that their brokers are executing transactions for their benefit, but it undermines the value of a discretionary account …. If such individuals cannot rely on a broker to exercise that discretion for their benefit, then the account loses its added value.").

B. The Investors' Withdrawals From Their Accounts Fall Within The §546(e) Safe Harbor

The Trustee's and SIPC's argument ignores not only the fundamental purpose of §546(e), but also the words of the statute. By its terms, §546(e) covers both any "settlement payment" and any transfer made "in connection with a securities contract." As this Court recently recognized, these separate categories of safe-harbored transfers must be given independent meaning, lest one be rendered superfluous. *In re Quebecor World (USA) Inc.*, 719 F.3d 94, 98 (2d Cir. 2013). The Trustee and SIPC concede that payments made to complete securities transactions are protected as "settlement payments." Trustee Br. 21-22; SIPC Br.

15. For the phrase "in connection with a securities contract" to have independent meaning, it must protect payments that did *not* settle securities transactions.

The transfers the Trustee seeks to avoid were made under contracts between Madoff and its investors—the "Account Agreements"—pursuant to which Madoff agreed that it would purchase and sell securities on its customers' behalf. The Account Agreements are "securities contracts" within the broad definition given to that term in the Bankruptcy Code—which includes any "contract for the purchase, sale, or loan of a security," 11 U.S.C. §741(7)(A)(i)—and the transfers the Trustee seeks to avoid were "in connection with" those agreements. In any event, even setting aside the Account Agreements, each customer's withdrawal order accepted by Madoff was itself a "securities contract."

The Trustee's contrary arguments lack merit. *First*, that Madoff lied to its customers and harbored an undisclosed intent to breach its agreements makes no difference. Under black-letter contract principles, the Account Agreements were still contracts, regardless of Madoff's breach. *Second*, to the extent the Trustee contends that "securities contracts" must necessarily be between a buyer and a seller of securities—and not, as here, between a broker-dealer and its customers—that argument is inconsistent with the text and purpose of §546(e). *Third*, contrary to the Trustee's argument, the Account Agreements were sufficiently definite to be "securities contracts," notwithstanding that they gave Madoff discretion over which securities to buy and sell, and did not themselves require or effect any specific securities transaction. *Finally*, this Court should reject the Trustee's appeal to rewrite the Bankruptcy Code and SIPA in order to effectuate his view of what is equitable.

1. The transfers the Trustee seeks to avoid were made in connection with securities contracts

The Bankruptcy Code defines "securities contract" to include any "contract for the purchase, sale, or loan of a security." 11 U.S.C. §741(7)(A)(i). An account agreement between a customer and a broker-dealer, authorizing the broker-dealer to make purchases and sales of securities on the customer's behalf, fits comfortably within that definition. Moreover, the statutory definition of "securities contract" enumerates many other types of agreements related to securities transactions, and for good measure includes a catch-all provision covering "any other agreement or transaction that is similar to an agreement or transaction referred to in this subparagraph." *Id.* §741(7)(A)(i), (vii); *see also In re Lehman Bros. Holdings Inc.*, 469 B.R. 415, 436 (Bankr. S.D.N.Y. 2012); *In re Refco, Inc. Sec. Litig.*, 2009 WL 7242548, at *3 n.4 (S.D.N.Y. Nov. 13, 2009), *adopted by* 2010 WL 5129072 (S.D.N.Y. Jan. 12, 2010). The investors' Account Agreements with Madoff were each "securities contracts" under that broad definition.

The Trustee concedes that the Account Agreements were binding contracts. Pursuant to the Account Agreements, Madoff opened investor accounts, agreed to purchase securities for those accounts when investors deposited funds, and agreed to sell securities when investors made withdrawal requests. *See* Trustee Br. 11 (citing Customer Agreement); *id.* at 12 (Trading Authorization). In the Trustee's own words, the Account Agreements "authorized Madoff to undertake future actions to 'buy, sell, and trade' securities," and provided for Madoff to sell securities in the investors' accounts "when they requested withdrawals." *Id.* at 11-12. Because, by the Trustee's own admission, the Account Agreements were entered into for the purpose of buying and selling securities, they are "securities contracts" under the plain terms of the statute.

In any event, even if the Trustee were correct that the Account Agreements were insufficiently specific to constitute "securities contracts"—and he is not (*see infra* pp.19-21)—each withdrawal order was a "securities contract." Each investor's order to withdraw funds from its account was a request that Madoff sell securities so that the investor could obtain the proceeds. Trustee Br. 11-12. Each withdrawal was thus a sale order, and when Madoff accepted that order, the parties contracted for the sale of a security. *See Lehman*, 469 B.R. at 437 (each separate extension of credit under agreement providing for discretionary extensions of credit was a securities contract); *In re Hawker Beechcraft, Inc.*, 2013 WL 2663193, at *10 (Bankr. S.D.N.Y. June 13, 2013) (each purchase order under two purchase-and-support agreements was separate contract under Bankruptcy Code). Each transfer is thus safe-harbored from avoidance on this ground as well.

Unlike the Trustee, SIPC does not dispute that Madoff's Account Agreements with its customers were "securities contracts." Instead, SIPC argues (at 27-30; *see also* Trustee Br. 36) that customers' withdrawals from their accounts were not "in connection with" those contracts because no actual securities transactions took place. But the statute requires only that a safe-harbored transfer be connected to a "securities contract," not that it be connected to an actual securities transaction. And courts have construed the term "in connection with" in §546(e) broadly to mean "related to." *Lehman*, 469 B.R. at 442; *In re Quebecor World (USA) Inc.*, 480 B.R. 468, 479 n.8 (S.D.N.Y. 2012) (same).[3] Investors' withdrawals from their Madoff accounts would not have taken place but for their Account Agreements with Madoff, and the withdrawals were made pursuant to the Account Agreements. The withdrawals were thus "related to"—that is, "in connection with"—the Account Agreements. *See Peterson v. Somers Dublin Ltd.*, --- F.3d ----, 2013 WL 4767495, at *6 (7th Cir. Sept. 6, 2013) (applying §546(e) to bar trustee's avoidance claims, finding that "'in connection with' … is more than

[3] The term "in connection with" as used in other federal statutes has likewise been construed broadly to encompass virtually anything that relates to the subject matter at issue. *See, e.g.*, *United States v. Nouri*, 711 F.3d 129, 143 (2d Cir. 2013) ("in connection with" requirement of criminal securities fraud statute is "broad" and "easily satisfied").

comprehensive enough to cover the Funds' redemption of the investors' shares").

2. Madoff's lies to its investors are irrelevant to this analysis

The Trustee acknowledges that Madoff represented to investors that it was complying with the Account Agreements by "engag[ing] in securities transactions." Trustee Br. 36. The Trustee nonetheless takes the position that because Madoff broke its promise to investors and defrauded them, there were no "securities contracts" in the first place. That is wrong for several reasons.

First, the Trustee's contention is contrary to the very premise of the statutory proceedings that gave rise to the Trustee's actions and, indeed, his appointment. Madoff was put into a SIPA liquidation, and the Trustee was appointed, because Madoff was a broker—a "person engaged in the business of effecting transactions in securities for the account of others," 15 U.S.C. §78c(a)(4)—that had securities "customers" and held "customer property," *id.* §78ffff(a)(1). This Court's application of SIPA and its case law to the Madoff liquidation has started from the proposition that Madoff's investors were "customers with claims for securities." *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 236 (2d Cir. 2011). If there were no "securities contracts" between Madoff and its investors, then Madoff would not have been a "broker," its customers would not have "claims for securities," and the Trustee and SIPC could not have invoked the protections of SIPA in the first place.

Second, the Trustee's argument is contrary to hornbook contract law. That Madoff lied to its investors, and breached its contracts with them, does not undermine the existence of the contracts themselves—a breached contract is a contract nonetheless. *Hasler v. West India S.S. Co.*, 212 F. 862, 866 (2d Cir. 1914) ("Neither the actual breach nor the prospective breach [of a contract] terminates the contract in and of itself. The contract still exists[.]"). It is irrelevant that Madoff may never have intended to honor the contracts, or that it fraudulently induced its investors to sign them. *Hotchkiss v. National City Bank of N.Y.*, 200 F. 287, 293 (S.D.N.Y. 1911) (Hand, J.); *see also The Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588, 595 (2001) (oral sale of option created a securities contract despite seller's secret intent not to honor it and constituted misrepresentation "in connection with the purchase and sale of security" under §10(b) of the Securities Exchange Act). The logical implication of the Trustee's argument is that no investor could sue Madoff for breach of the parties' agreement because there never was such an agreement. That is not—and certainly should not be—the law.

Third, the Trustee's argument is also inconsistent with the law of this Circuit, as applied to the very same Ponzi scheme. In *In re Herald*, --- F.3d. ----, 2013 WL 5046509 (2d Cir. Sept. 16, 2013), this Court considered whether state-law claims by Madoff customers against financial institutions that held Madoff's accounts were based on "a misrepresentation or omission of a material fact *in connection with the purchase or sale of* a covered *security*," 15 U.S.C. §78bb(f)(1)(A) (emphasis added), and therefore were preempted by the Securities Litigation Uniform Standards Act. Affirming the district court, this Court held that "the fact that Madoff Securities may not have actually executed their pretended securities trades does not take this case outside the ambit of SLUSA." 2013 WL 5046509, at *4. There is no reason why the result should be different here: Just as Madoff's lies to its customers did not preclude SLUSA from applying, so too they have no effect on the application of the similarly worded safe harbor of §546(e).

Finally, Section 546(e)'s safe harbor for transfers made "in connection with a securities contract" is not displaced or rendered inapplicable merely because a broker-dealer acts fraudulently with respect to an otherwise valid investment agreement. To the contrary, Congress drew the boundaries for the safe harbor and enacted only one exception. It made the judgment that *all* avoidance actions brought under "sections 544, 545, 547, 548(a)(1)(B), and 548(b)" would be barred if they involve transfers "in connection with a securities contract," and only those transfers that were actually fraudulent and made within two years of the bankruptcy could be avoided under §548(a)(1)(A). 11 U.S.C. §546(e). "The fact that Congress did expressly exclude Section 548(a)(1)(A) implies that it did not want to exclude [other] fraudulent transfer claims." *U.S. Bank Nat'l Ass'n v.*

Verizon Commc'ns, Inc., 892 F. Supp. 2d 805, 817 (N.D. Tex. 2012).

3. The Account Agreements were securities contracts even though they were between a broker and its customer, and even though they authorized discretionary trading

The Trustee offers two additional arguments as to why the entirely commonplace Account Agreements between Madoff and its customers are not "securities contracts" within the meaning of the Bankruptcy Code. At the outset, it is worth noting that neither of these arguments turns on Madoff's fraud or the characteristics of Ponzi schemes more broadly. Rather, each argument assails the managed investment industry generally. If adopted by this Court, the Trustee's reasoning would take the agreements that undergird that industry outside the protection of the safe harbor of §546(e) even where the broker-dealer does engage in securities transactions for its customers—causing the disastrous effects on the securities markets that Congress sought to avoid in enacting the safe harbor. The Trustee's arguments are meritless.

First, the Account Agreements are "securities contracts" even though they were between a broker-dealer and its customers, and not between a buyer and seller of securities. A "securities contract" includes "a contract for the purchase, sale, or loan of a security." 11 U.S.C. §741(7)(A)(i). An account agreement with a broker-dealer easily meets that definition because such an agreement contemplates and authorizes a "purchase, sale, or loan of a security" by the broker-dealer on the investor's behalf. Contrary to the Trustee's suggestion, the definition does not require that the contract be between the seller and the buyer of the security. Congress could easily have incorporated such a limitation—all it had to do was add the words "between a seller and a buyer" after "a contract"—but it chose not to do so.[4]

Second, the Account Agreements are "securities contracts" even if they authorized discretionary trading. The Trustee is mistaken in suggesting that a discretionary investment account cannot give rise to a "securities contract" because it does not provide for the purchase or sale of a specified security. Trustee Br. 12. A "securities contract" includes any contract "for the purchase [or] sale … of a security." 11 U.S.C. §741(7)(A)(i). The definition is not limited to contracts for the purchase or sale of a particular security specified by the investor. That is consistent with the marketwide practice of discretionary trading accounts, in which

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[4] The Trustee attempts to analogize the agreements between Madoff and its customers to an agreement between a homeowner and a real estate broker. The analogy is inapt. To be sure, when the owner of a house hires a broker to list his house for sale, that is not a contract for the sale of the house. But that is because the owner has made no binding commitment to sell the house, nor has the broker made a binding commitment to find a buyer. Entering into an agreement with a broker to buy or sell publicly traded securities is fundamentally different. The securities markets are liquid in a way that the housing market is not, allowing buyers and sellers to be matched up definitively and immediately. *See* 5 Hazen, *Law of Securities Regulation* §14.10 (2009). When an investor tells his broker to sell stock in a public company in his account so that he may make a withdrawal, there is no uncertainty as to whether the broker can do so, and there is thus an agreement for the sale of securities.

customers grant brokers general authorization to buy and sell securities for their account rather than directing the purchase and sale of specific securities. *See In re Weisberg*, 136 F.3d 655, 658 (9th Cir. 1998) (client agreement that did not provide for any particular purchases or sales of securities, but authorized broker to sell stocks upon failure to meet margin call, "involved the 'purchase and sale of securities' and thus qualified as a securities contract" under §741(7)); *see also Wharf*, 532 U.S. at 595; *MBS*, 690 F.3d at 356. Investors routinely give their investment advisors discretionary trading authority, and the terms of §546(e)—and the purpose of the statute to protect markets from widespread disarray—are more than broad enough to encompass such common contractual arrangements. *See MBS*, 690 F.3d at 355 (rejecting trustee's argument, which, "if correct, would exclude many natural gas, fuel and electricity requirements contracts from the Section 546(e) shield against preference recovery").

4. Neither this Court's "net equity" decision nor the Trustee's equitable concerns provide a basis for reversal

The Trustee contends that the district court's decision undermines this Court's "net equity" opinion, *In re Bernard L. Madoff Investment Securities LLC*, 654 F.3d 229 (2d Cir. 2011), and would hinder equitable distribution of the estate's assets. To the contrary, the point of the net equity decision was that Madoff's investors—individuals and entities who entered into agreements obligating Madoff to buy and sell securities on their behalf—were "customers with claims for securities," and therefore had priority over the other creditors in the distribution of Madoff's assets. *Id.* at 236. The net equity decision starts from the premise that Madoff was a broker-dealer that contracted with its investors for the purpose of buying and selling securities. The decision thus supports application of the safe harbor here.

In any event, the Trustee cannot rewrite the Bankruptcy Code or SIPA. His argument is essentially that this Court cannot apply §546(e) as written because doing so would interfere with his equitable powers. But as this Court recently explained in rejecting the Trustee's equitable pleas in a different Madoff-related appeal, the plain language of the statute controls. *See In re Bernard L. Madoff Inv. Sec. LLC.*, 721 F.3d 54, 76 (2d Cir. 2013) ("[E]quity has its limits; it may fill certain gaps in a statute, but it should not be used to enlarge substantive rights and powers."). As the district court noted below, the net equity decision "does not permit the Trustee to suspend the whole legal order in pursuit of a result he regards as equitable." *SIPC v. Bernard L. Madoff Inv. Sec. LLC,* 476 B.R. 715, 722 n.7 (S.D.N.Y. 2012).

At any rate, the Trustee overstates his equitable concerns when he contends that "practically every transfer of funds by the broker" will be shielded by §546(e), and that "net winners" will reap a windfall, if §546(e) bars his avoidance claims. Trustee Br. 50-55. This case encompasses only a subset of transfers from

Madoff's scheme—transfers to "net winners" unaware of Madoff's fraud who withdrew funds before the two-year look-back period of §548(a)(1)(A), and "net losers" who withdrew funds within the ninety-day preference period of §547 prior to the bankruptcy filing. The Trustee has ample tools at his disposal to avoid and recover other transfers.

For instance, the district court has held that investors who had actual knowledge of Madoff's fraud are not covered by the §546(e) safe harbor, whenever they withdrew their money, because "[n]either law nor equity permits such a person to profit from a safe harbor intended to promote the legitimate workings of the securities markets and the reasonable expectations of legitimate investors." *SIPC v. Bernard L. Madoff Inv. Sec. LLC*, 2013 WL 1609154, at *4 (S.D.N.Y. Apr. 15, 2013).[5] The Trustee can also sue Madoff family members and others for compensation and other distributions they received from Madoff that did not even purport to be the proceeds of securities investments.

While investors who were unaware of Madoff's fraud and who withdrew

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5 The Trustee chides the district court for its determination that a customer's "actual knowledge" that Madoff would not buy or sell securities is relevant to the applicability of §546(e). Trustee Br. 57-58. But the district court's holding is in accord with the basic rule of contracts that when neither party intends to abide by the written terms of a contract, there is no binding agreement between them. *See, e.g.*, *Peninsula Group Capital Corp. v. United States*, 93 Fed. Cl. 720, 730 (2010) ("This prevented a contract from forming, because neither party intended to be bound by their statements.").

their money more than two years ago may keep their net winnings (and net losers can keep their withdrawals made within ninety days of the Madoff SIPA filing), that result is a consequence of Congress's balancing of "two important national legislative policies on a collision course—the policies of bankruptcy and securities law." *Enron*, 651 F.3d at 334. The Trustee's argument is nothing more than a wholesale challenge to the policy choices that Congress made in limiting avoidance powers under SIPA and the Code. Congress could have made §546(e) inapplicable to SIPA liquidations, just as it made §546(e) inapplicable to intentionally fraudulent transfers under §548(a)(1)(A). But it did not. Instead, as this Court recently recognized, Congress constrained a SIPA trustee in the same manner as a bankruptcy trustee. *Madoff*, 721 F.3d at 58. The decision Congress made to preclude such a trustee from avoiding transfers made "in connection with a securities contract" except for intentionally fraudulent transfers within the two-year window must be respected.

II. FAILING TO ENFORCE §546(e) IN THIS CASE WILL THWART CONGRESS'S INTENT AND THREATEN THE DAY-TO-DAY OPERATION OF THE SECURITIES MARKETS

The Trustee professes to act in the best interests of ordinary investors. From that standpoint, his position is short-sighted. If he prevails here, the untoward consequences of his victory are likely to reverberate through the securities markets—far beyond this case and even beyond the special circumstance of Ponzi schemes—because, as much as the Trustee argues otherwise, this case is not unique. While the scale of Madoff's fraud was exceptional, it was not the first and will not be the last Ponzi scheme. And the contractual relationship between Madoff and its customers was anything but unusual. A ruling that §546(e) does not protect the investors here will undermine the confidence upon which the broker-investor relationship rests and threaten the clearing/depository system upon which that relationship depends.

The investors before this Court are no different from the millions of other investors around the country who have opened investment accounts. Like most other investors, the customers here gave Madoff discretion to trade securities on their behalf as it saw fit; allowed it to hold their securities "in street name"—that is, in the broker's or other nominee's name—without obtaining paper certificates; and relied on it to confirm their trades electronically. They lacked any knowledge of or complicity in Madoff's fraud, and they thought that Madoff was operating a legitimate business.[6] When they withdrew money from their accounts, they

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[6] The Trustee mistakenly suggests that under the district court's approach, an evidentiary hearing to determine each individual investor's good faith is required to resolve each of his adversary proceedings. Trustee Br. 34. That approach would undermine Congress's objectives in enacting the safe harbor's absolute bar on unwinding securities transactions (*i.e.*, certainty and stability in the securities markets). *See, e.g.*, *In re Enron Corp.*, 323 B.R. 857, 870 (Bankr. S.D.N.Y. 2005) ("Whether the safe harbor of section 546 of the Bankruptcy Code is or is not a bar to the avoidance claim is a matter of law that can be determined based on the confirmations and the allegations of the Complaint."). The complaints that the

believed that they were redeeming the proceeds of securities Madoff had sold on their behalf, as Madoff represented. Indeed, Madoff's customers received a monthly statement "list[ing] securities transactions purportedly executed during the reporting period and purported individual holdings in various Standard & Poor's 100 Index stocks," and "the great majority of investors relied on their customer statements for purposes of financial planning and tax reporting, to their terrible detriment." *Madoff*, 654 F.3d at 231-232.

Congress enacted §546(e) to minimize the disruption to the securities markets in the event of a bankruptcy in the financial sector. *See supra* pp.8-10. Depriving the customers here of the safe harbor—even though its plain terms apply—would have the opposite effect: It would leave numerous participants in the markets subject to attacks on transactions that they reasonably expected, in accordance with their securities contracts with Madoff, were final and certain. Because the safe harbor with respect to alleged fraudulent transfers applies only to withdrawals outside the two-year limitations period for actions under §548(a)(1)(A), these transactions have been long settled, and in all likelihood the investors have used the withdrawn money for other purposes. If the transactions

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district court dismissed did not allege that the defendants were aware of Madoff's fraud and did not expect it to buy or sell securities for their accounts. The Trustee cannot avoid dismissal based on supposed facts that his own complaints do not allege.

were unwound, not only would the investors have to return money that they have long and reasonably believed was theirs, but they could well have to liquidate other assets in order to do so. In short, the failure to apply §546(e) in these cases would create the very market disruption that §546(e) was designed to prevent and that the Trustee is nominally seeking to avert.

In turn, that disruption would jolt investors' faith in their investment advisers, to the detriment of the efficiency and liquidity of the securities markets. If the safe harbor were held inapplicable whenever an investment adviser lied to an investor and did not actually buy and sell securities for the investor's account, investors could no longer have confidence—as the Madoff customers did—in the electronic trading and confirmation system that is essential to modern-day securities trading. That would be a substantial step backwards for the securities markets and for investors of all stripes.

Formerly, brokers provided their investors with paper certificates of securities each time they bought a security on an investor's behalf. But as investing became more widespread, brokers were overwhelmed by the administrative burdens of this practice. The "rapid growth of the securities industry during the 1960s, spurred by an enormous unanticipated increase of trading volume, resulted in a 'paperwork' crisis for broker-dealers," and "by the end of the decade evidence mounted of general breakdown in the industry."

23A Markham & Hazen, *Broker-Dealer Operations Under Securities & Commodities Law* §13:1 (2006). In response, the securities markets embraced a new centralized settlement system, through which a broker holds securities for his investor in "street name"—that is, "in the name of the customer's broker-dealer with the clearing house or depository." *Id.* §13:13. This system radically streamlined the relationship between brokers and investors, and it is now integral to the efficient functioning of the securities markets—indeed, SIPC devotes much of its brief (at 17-27) to underscoring this very proposition.

This progress would be thwarted if the Trustee prevails. If investors cannot trust that withdrawals from their brokerage accounts are protected by §546(e) in the event that their broker is a fraud, they will not be able to rely on the standard account statements they receive from the broker describing the securities bought and sold for their accounts. Instead, to be certain of the validity of such transactions, investors will have to demand paper certificates from the broker. The resulting administrative burdens will almost certainly lead to another "paperwork crisis," especially since the volume of trading has grown exponentially. Given that Congress enacted SIPA to "restore investor confidence in the capital markets," *SIPC v. Barbour*, 421 U.S. 412, 415 (1975), and has likewise amended and expanded §546(e) several times in order to accommodate and protect evolving and constantly-innovating securities markets, it would defeat the purpose of the statute to revert back to the slow and costly days of trading and filing paper stock certificates.

CONCLUSION

For the reasons discussed above, this Court should affirm the district court's dismissal of the complaints.

Respectfully submitted.

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32(a)(7)(C), the undersigned hereby certifies that this brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7)(B).

1. Exclusive of the exempted portions of the brief, as provided in Federal Rule of Appellate Procedure 32(a)(7)(B), the brief contains 6,844 words.

2. The brief has been prepared in proportionally spaced typeface using Microsoft Word 2010 in 14 point Times New Roman font. As permitted by Federal Rule of Appellate Procedure 32(a)(7)(C), the undersigned has relied upon the word count feature of this word processing system in preparing this certificate.

/s/ Philip D. Anker
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October 18, 2013

CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of October 2013, I caused the foregoing brief to be filed with the Clerk of Court via the CM/ECF system, thereby effecting electronic service on counsel for all parties.

/s/ Philip D. Anker
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