20-1333

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

In Re: BERNARD L. MADOFF INVESTMENT SECURITIES LLC,

Debtor.

IRVING H. PICARD, TRUSTEE FOR THE SUBSTANTIVELY CONSOLIDATED SIPA LIQUIDATION OF BERNARD L. MADOFF INVESTMENT SECURITIES LLC and THE ESTATE OF BERNARD L. MADOFF,

Plaintiff-Appellant,

(Caption Continued on the Reverse)

On Appeal from the United States Bankruptcy Court for the Southern District of New York

BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AND THE AMERICAN BANKERS ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF DEFENDANTS-APPELLEES

Emil A. Kleinhaus
WACHTELL, LIPTON, ROSEN & KATZ
Attorneys for Amici Curiae
The Securities Industry and Financial Markets Association and The American Bankers Association
51 West 52nd Street
New York, New York 10019
212-403-1000

SECURITIES INVESTOR PROTECTION CORPORATION,

Appellant,

v.

CITIBANK, N.A., CITICORP NORTH AMERICA, INC.,

Defendants-Appellees.

CORPORATE DISCLOSURE STATEMENT

Neither the Securities Industry and Financial Markets Association nor the American Bankers Association has a parent corporation, and no publicly held corporation owns 10 percent or more of the stock of either organization.

Case 20-1333, Document 136, 11/12/2020, 2973137, Page4 of 42

TABLE OF CONTENTS

PAGE

CORPORATE DISCLOSURE STATEMENT ii

TABLE OF AUTHORITIES.................................... v

STATEMENT OF INTEREST OF *AMICI CURIAE*.. 1

SUMMARY OF ARGUMENT.................................. 3

ARGUMENT 7

POINT I

THE DISTRICT COURT CORRECTLY HELD THAT GOOD FAITH DEPENDS ON A TRANSFEREE'S KNOWLEDGE AND CULPABILITY AND NOT ON INQUIRY NOTICE... 7

A. Statutory Language...................................... 7

B. Statutory Structure and Purpose 9

C. Statutory History.. 11

D. Recent Case Law 14

POINT II

THE DISTRICT COURT CORRECTLY ADOPTED A SUBJECTIVE GOOD FAITH TEST IN THE CONTEXT OF A LOAN REPAYMENT... 19

Case 20-1333, Document 136, 11/12/2020, 2973137, Page5 of 42

POINT III

FEDERAL SECURITIES LAW SUPPORTS A SUBJECTIVE GOOD FAITH TEST AND IMPOSING THE PLEADING BURDEN ON THE TRUSTEE. 23

CONCLUSION 28

TABLE OF AUTHORITIES

PAGE(S)

Cases

Bank Melli Iran v. *Pahlavi*, 58 F.3d 1406 (9th Cir. 1995) 28

Bear, Stearns Secs. Corp. v. *Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1 (S.D.N.Y. 2007)..15

Boston Trading Group, Inc. v. *Burnazos*, 835 F.2d 1504 (1st Cir. 1987) 21

Brown v. *Felsen*, 442 U.S. 127 (1979) 8

Chiarella v. *U.S.*, 445 U.S. 222 (1980) 25

Christian Brothers High Sch. Endowment v. *Bayou No Leverage Fund, LLC (In re Bayou Grp., LLC)*, 439 B.R. 284 (S.D.N.Y. 2010) 15

Clear Blue Water, LLC v. *Oyster Bay Mgmt. Co., LLC*, 476 B.R. 60 (E.D.N.Y. 2012)...................8

Coder v. *Arts*, 213 U.S. 223 (1909)............................20

Davis v. *Schwartz*, 155 U.S. 631 (1895) 20, 21

Dekalb Cnty. Pension Fund v. *Transocean Ltd.*, 817 F.3d 393 (2d Cir. 2016)..........................26

Enron Creditors Recovery Corp. v. *Alfa, S.A.B. de C.V.*, 651 F.3d 329 (2d Cir. 2011) 11

Ernst & Ernst v. *Hochfelder*, 425 U.S. 185 (1976) 24, 25, 26

Gilmer v. *Woodson*, 332 F.2d 541 (4th Cir. 1964) 14

Goldman v. *Capital City Mortg. Corp. (In re Nieves)*, 648 F.3d 232 (4th Cir. 2011) 16, 24

Gowan v. *Patriot Grp., LLC (In re Dreier LLP)*, 452 B.R. 391 (Bankr. S.D.N.Y. 2011) 15, 16

Gowan v. *Westford Asset Mgmt. LLC (In re Dreier LLP)*, 462 B.R. 474 (Bankr. S.D.N.Y. 2011) 16

Hayes v. *Palm Seedlings Partners (In re Agric. Research & Tech. Group, Inc.)*, 916 F.2d 528 (9th Cir. 1990) 18

HBE Leasing Corp. v. *Frank*, 48 F.3d 623 (2d Cir. 1995) 16, 20

Herman & MacLean v. *Huddleston*, 459 U.S. 375 (1983) 25, 26

In re Bernard L. Madoff Inv. Sec. LLC, 818 F. App'x 48 (2d Cir. 2020) 26, 27

In *re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347 (2d Cir. 2010) 26

In re Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006) 9

J. Walter Thompson, U.S.A., Inc. v. *First BankAmericano*, 518 F.3d 128 (2d Cir. 2008) 8

Jimmy Swaggart Ministries v. *Hayes (In re Hannover Corp.)*, 310 F.3d 796 (5th Cir. 2002) 16

Jobin v. *McKay (In re M & L Business Machine Co.)*, 84 F.3d 1330 (10th Cir. 1996) 17

Lanza v. *Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973)..25

Lawson v. *Ford Motor Co. (In re Roblin Indus., Inc.)*, 78 F.3d 30 (2d Cir. 1996) 20

Lippe v. *Bairnco Corp.*, 249 F. Supp. 2d 357, 375 (S.D.N.Y. 2003)...10

Marshall v. *Picard (In re BLMIS LLC)*, 740 F.3d 81 (2d Cir. 2014) 15

Matter of Cohoes Indus. Terminal, Inc., 931 F.2d 222 (2d Cir. 1991) 8

Meoli v. *Huntington Nat'l Bank (In re Teleservices Group, Inc.)*, 444 B.R. 767 (Bankr. W.D. Mich. 2011)....................................17

Meoli v. *The Huntington Nat'l Bank*, 848 F.3d 716 (6th Cir. 2017).................................18, 19

Picard v. *Ida Fishman Revocable Trust (In re Bernard L. Madoff Inv. Sec. LLC)*, 773 F.3d 411 (2d Cir. 2014) 11, 24

Picard v. *Katz*, 462 B.R. 447 (S.D.N.Y. 2011) 4, 25

Rolf v. *Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir. 1978) 25

Rothman v. *Gregor*, 220 F.3d 81 (2d Cir. 2000) 25

Sebelius v. *Cloer*, 569 U.S. 369 (2013)........................7

SEC v. Packer, Wilbur & Co., 498 F.2d 978 (2d Cir. 1974)..24

Case 20-1333, Document 136, 11/12/2020, 2973137, Page9 of 42

SEC v. *Yorkville Advisors, LLC*, 305 F. Supp. 3d 486 (S.D.N.Y. 2018) 27

Sharp Int'l Corp. v. *State St. Bank & Trust Co. (In re Sharp Int'l Corp.)*, 403 F.3d 43 (2d Cir. 2005) 20, 22, 23

Shauer v. *Alterton*, 151 U.S. 607 (1894) 18

Smith v. *Whitman*, 189 A.2d 15 (N.J. 1963) 14

Stone v. *Ritter*, 911 A.2d 362 (Del. 2006) 8

Tacoma Ass'n of Credit Men v. *Lester*, 433 P.2d 901 (Wash. 1967) 13

Templeton v. *O'Cheskey (In re Am. Hous. Found.)*, 785 F.3d 143 (5th Cir. 2015) 16

United States v. *Ron Pair Enters., Inc.*, 489 U.S. 235 (1989) 7

Statutes

11 U.S.C. § 1112 8

11 U.S.C. § 546(e) 11

11 U.S.C. § 548(a) 3

11 U.S.C. § 548(c) 3, 9

11 U.S.C. § 550(a)(2) 3

11 U.S.C. § 550(b)(1) 3, 9, 27

15 U.S.C. § 78bbb 24

15 U.S.C. § 78r(a) 26

15 U.S.C. § 78t(a) 26

15 U.S.C. §§ 78aaa-lll 2

N.Y. Debt. & Cred. Law §§ 270–281 (2019) 13

Case 20-1333, Document 136, 11/12/2020, 2973137, Page10 of 42

N.Y. U.C.C. § 1-201(b)(20) 8
UFCA § 3(a) 12
UFCA § 9 12
UFCA §§ 4-6 12

Other Authorities

1 G. Glenn, FRAUDULENT CONVEYANCES AND PREFERENCES (rev. ed. 1940) 10, 14, 16, 21

30 N.Y. Jur. 2d Creditors' Rights & Remedies § 305...10

5 Charles Alan Wright & Arthur R. Miller, FEDERAL PRACTICE AND PROCEDURE (3d ed. 2020) 28

BALLENTINE'S LAW DICTIONARY (3d ed. 1969) 8

BLACK'S LAW DICTIONARY (11th ed. 2019)...................7

Collier on Bankruptcy ¶ 548.01 (16th ed. 2020) 12

Craig T. Lutterbein, *"Fraud and Deceit Abound" but Do the Bankruptcy Courts Really Believe Everyone Is Crooked: The* Bayou *Decision and the Narrowing of "Good Faith,"* 18 Am. Bankr. Inst. L. Rev. 405 (2010) 17

H.R. REP. No. 85, 73d Cong., 1st Sess., 1-5 (1933)...24

H.REP. No. 595, 95th Cong., 1st Sess. 177-78 (1977), *reprinted in* U.S.Code Cong. & Admin. News 5963, 6138 20

Case 20-1333, Document 136, 11/12/2020, 2973137, Page11 of 42

MERRIAM-WEBSTER INC., WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY (Frederick C. Mish et al. 1988) 7

Note, *Good Faith and Fraudulent Conveyances*, 97 Harv. L. Rev. 495 (1983) 13

Paul Sinclair, *The Sad Tale of Fraudulent Transfers (Part II): When Did Ponzi Preferences Morph into Fraudulent Transfers?*, 28 Am. Bankr. Inst. J. 44 (May 2009)..17

Paul Sinclair, *The Sad Tale of Fraudulent Transfers: The Unscrupulous Are Rewarded and the Diligent Are Punished*, 28 Am. Bankr. Inst. J. 16 (Apr. 2009) 9, 18

Report of the Committee on Uniform State Laws, 5 A.B.A. J. 481 (1919)................................14

Richard B. Levin, *An Introduction to the Trustee's Avoiding Powers*, 53 Am. Bankr. L.J. 173 (1979)..12

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

No. 20-1333

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

On Appeal from the United States Bankruptcy Court for the Southern District of New York

BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AND THE AMERICAN BANKERS ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF DEFENDANTS-APPELLEES

STATEMENT OF INTEREST OF *AMICI CURIAE*[1]

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers. SIFMA champions policies and practices that foster a strong financial industry, while promoting investor opportunity, capital formation, job creation, economic growth and trust and confidence in the financial

[1] No counsel for a party authored this brief in whole or in part, and no one other than *amici curiae*, their members, or their counsel contributed money to fund the preparation or submission of this brief.

markets. SIFMA regularly files *amicus curiae* briefs in cases that raise important questions of commercial and securities law.

The American Bankers Association ("ABA") is the principal national trade association of the financial services industry in the United States. Founded in 1875, the ABA is the voice for the nation's $13 trillion banking industry. ABA members provide banking services in each of the fifty States and the District of Columbia. ABA's membership includes all sizes and types of financial institutions. ABA regularly files *amicus curiae* briefs in cases that significantly affect its members and the business of banking or lending.

The members of SIFMA and ABA, as lenders and participants in the capital markets, are at times exposed to companies that engage in fraud or otherwise become insolvent. It is important to members of SIFMA and ABA that — in construing and applying the provisions of title 11 of the U.S. Code (the "Bankruptcy Code") and the Securities Investor Protection Act of, 15 U.S.C. §§ 78aaa-lll ("SIPA") — the courts apply predictable and clear rules that minimize market disruption and respect the finality of transfers to market participants that did not knowingly participate in fraud or misconduct.

As discussed below, the Trustee's position in this case, under which "good faith" under Sections 548(a) and 550(b) of the Bankruptcy Code would be analyzed under an objective "inquiry notice" standard, would subject firms and individuals to substantial uncertainty, and would impose new and amorphous duties on lenders and other investors that are divorced from the concept of "good faith" as ordinarily understood. By contrast, the district court's

interpretation of "good faith," under which lack of good faith requires actual knowledge of or at least willful blindness to a debtor's malfeasance, provides a fair and workable standard consistent with precedent and market expectations.

This brief is submitted pursuant to Fed. R. App. P. 29(a)(2), as all parties have consented to its filing.

SUMMARY OF ARGUMENT

This case presents an important opportunity for this Court to clarify the meaning of the term "good faith" as used in Sections 548(c) and 550(b) of the Bankruptcy Code and applied in the context of the Bernard Madoff SIPA liquidation.

Section 548(a) of the Bankruptcy Code permits a bankruptcy trustee to avoid transfers made with the intent to hinder, delay or defraud creditors, or transfers made for lack of reasonably equivalent value while the debtor is in a compromised financial condition. 11 U.S.C. § 548(a). Section 548(c), however, prevents avoidance of a transfer under Section 548(a) when the transferee takes the transfer "for value and in good faith." 11 U.S.C. § 548(c).

Section 550(a) permits the trustee to recover an avoided transfer not only from the initial transferee but also from "any immediate or mediate transferee of such initial transferee." 11 U.S.C. § 550(a)(2). But under Section 550(b), the transfer may not be recovered if such a subsequent transferee "takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided." 11 U.S.C. § 550(b)(1).

Accordingly, under both Sections 548(c) and 550(b), the transferee's "good faith" will be decisive — and will prevent liability from being imposed — *only* when the transferee has given "value" for the transfer at issue. If the transferee has not given value in exchange for the property received, and the other prerequisites for avoidance are met, transferees are subject to liability *regardless* of their good faith. Thus, in determining the meaning of "good faith," the Court is being asked to decide when a transferee's conduct is so reprehensible that it should have liability despite having provided value equivalent to what it received.

The meaning of "good faith" has taken on great significance in the Madoff liquidation. That is because, under the so-called Ponzi scheme presumption, *all* transfers by Bernard L. Madoff Investment Securities, LLC ("BLMIS") are deemed to have been made by BLMIS with actual intent to hinder, delay and defraud creditors.[2] At the same time, under now-settled law, BLMIS's return to customers of amounts originally invested, as opposed to "fictitious profits," are considered to be for "value," because the customers have a valid "net equity" claim for those amounts.[3] Thus, in cases against initial-transferee customers to recover principal rather than profits, Section 548(c)'s "good faith" requirement is decisive.

In cases such as the *Citibank* case — where the Trustee has pursued claims against subsequent transferees, the "good faith" question is likewise

---

[2] *E.g.*, *Picard* v. *Katz*, 462 B.R. 447, 453 (S.D.N.Y. 2011).

[3] *Id*. at 453.

critical. Various subsequent transferees, including Citibank, indisputably provided "value" for what they received, because they made *loans* to the initial transferees that were repaid. SPA60. Thus, any liability again depends on the transferee-lender's "good faith" under Section 550(b).

In the decisions on appeal, the courts below applied a subjective "good faith" test under which a transferee's good faith turns on whether the transferee was willfully blind to or had actual knowledge of the Madoff Ponzi Scheme. SPA4-5. In adopting that construction, the district court emphasized that this is a SIPA liquidation and that BLMIS was a broker-dealer. The district court thus drew on federal securities law, and the expectations of securities-market participants, to buttress its interpretation of good faith, observing that a "securities investor has no inherent duty to inquire about his stockbroker" and that "[t]he Trustee's approach would impose a burden of investigation on investors totally at odds with the investor confidence and securities market stability that SIPA is designed to enhance." SPA7. On the other hand, "that does not mean that an investor may purposely close her eyes to what is plainly to be seen," and therefore an investor may be held liable if the investor has actual knowledge of fraud or "willfully blinded himself to circumstances indicating a high probability of fraud." SPA8-9.

SIFMA and ABA respectfully submit that the district court was *correct* in holding that lack of good faith requires actual knowledge of, or at least willful blindness to, the debtor's fraud. As a general matter, and setting aside the particular circumstances of this

case, there is no sound basis to equate "good faith" with "inquiry notice" or the "reasonableness" of an investigation. Rather, as a matter of plain meaning and ordinary usage, "good faith" is a subjective concept that turns on a person's knowledge and culpability. Moreover, limiting findings of bad faith to situations involving knowledge of wrongdoing avoids punitive and unfair results. *See* Point I, below.

Regardless of the general standard, the "inquiry notice" test was correctly rejected in this particular case, which involves repayment of *loans* made by a bank (Citibank) to customers of a broker-dealer (Madoff investors). Application of an inquiry-notice standard on these facts would depart from longstanding case law interpreting "good faith" in the context of debt repayments, under which receiving repayment of a valid debt is not "bad faith" absent culpability in fraud. *See* Point II, below.

The district court was also justified in looking to securities law both in construing good faith and deciding the good-faith issue on the pleadings. In the context of a SIPA proceeding, where the debtor was an SEC-registered broker-dealer, allowing the Trustee to bring claims against anyone who received a transfer — while imposing the burden on the transferee to defend its failure to detect a decades-long fraud that escaped the notice of regulators and countless others — would create substantial uncertainty while imposing burdens on investors that have no legal foundation. *See* Point III, below.

ARGUMENT

POINT I

THE DISTRICT COURT CORRECTLY HELD THAT GOOD FAITH DEPENDS ON A TRANSFEREE'S KNOWLEDGE AND CULPABILITY AND NOT ON INQUIRY NOTICE.

A. Statutory Language

The term "good faith" is not defined in the Bankruptcy Code. Accordingly, it should be given its "plain meaning" in the English language. *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989); *Sebelius* v. *Cloer*, 569 U.S. 369, 376 (2013) ("statutory terms are generally interpreted in accordance with their ordinary meaning").

In any context — whether a SIPA liquidation or a regular bankruptcy case — the concept of "good faith," as ordinarily understood, does not denote "inquiry notice" or diligent investigation. The word "faith," by definition, refers to a person's subjective thought process or "sincerity of intentions." MERRIAM-WEBSTER INC., WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 446 (Frederick C. Mish et al. 1988). Likewise, the phrase "good faith," as used in various areas of the law, has been defined to mean "[a] *state of mind* consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage." BLACK'S LAW DICTIONARY (11th ed. 2019) (emphasis added). Another legal dictionary defines "in good faith" as "[w]ith honesty, whether done

negligently or not." BALLENTINE'S LAW DICTIONARY (3d ed. 1969).

Similarly, the Uniform Commercial Code generally defines "good faith" as "honesty in fact." N.Y. U.C.C. § 1-201(b)(20). Consistent with that definition, this Court has concluded that the U.C.C.'s standard of good faith "does not impose a standard of care but, rather, a standard of fair dealing." *J. Walter Thompson, U.S.A., Inc.* v. *First BankAmericano*, 518 F.3d 128, 139 (2d Cir. 2008) (rejecting claim against bank that mistakenly honored altered check because, even if the bank were negligent, the absence of "dishonesty" precluded a finding of bad faith).

The concept of good faith is also used in other areas of bankruptcy law — in a clearly subjective way. For example, in considering whether to dismiss a bankruptcy for "cause" under 11 U.S.C. § 1112, courts apply a "good faith standard," the "premise" of which "is that bankruptcy relief should generally be limited only to the 'honest but unfortunate debtor.'" *Clear Blue Water, LLC* v. *Oyster Bay Mgmt. Co., LLC*, 476 B.R. 60, 70 (E.D.N.Y. 2012) (citing *Brown* v. *Felsen*, 442 U.S. 127, 128 (1979)); *see also Matter of Cohoes Indus. Terminal, Inc.*, 931 F.2d 222, 228 (2d Cir. 1991) (Chapter 11 case filed in bad faith where the petitioner "did not have a genuine intent to emerge from bankruptcy as a rejuvinated organization").

As another example, Delaware corporate law imposes a duty of good faith as a component of the directors' duty of loyalty, separate from the directors' duty of care. *See, e.g.*, *Stone* v. *Ritter*, 911 A.2d 362, 370 (Del. 2006). The Delaware Supreme Court has explained that "[a] failure to act in good faith may be shown, for instance, where the fiduciary *intentionally*

acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the *intent* to violate applicable positive law, or where the fiduciary *intentionally* fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties." *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006) (emphases added).

These authorities confirm what follows from ordinary English usage: Contrary to the Trustee's position, a "good faith" test does not require a transferee to meet a "reasonable firm" standard or to conduct a "diligent" investigation prior to accepting a payment. Trustee Br. 19. Someone can act in good faith even if he or she is negligent or not diligent. As one commentator observed, "if Congress had meant the words 'knew or should have known' in § 548(c), it could have used those words. Instead, it used the words 'good faith,' which have nothing other than a subjective meaning." Paul Sinclair, *The Sad Tale of Fraudulent Transfers: The Unscrupulous Are Rewarded and the Diligent Are Punished*, 28 Am. Bankr. Inst. J. 16, 79-80 (Apr. 2009).

B. Statutory Structure and Purpose

Sections 548(c) and 550(b) of the Bankruptcy Code prevent recovery of a transfer where the transferee has given "value" *and* has acted in "good faith." 11 U.S.C. §§ 548(c), 550(b)(1). Thus, if a transferee does not give value in exchange for a transfer — and the transfer was intended to hinder, delay or defraud creditors, or was made while the debtor was insolvent — the transferee will have to return the transfer *regardless* of good faith. The good faith standard,

accordingly, only matters when the transferee has given value. In that circumstance, a finding of bad faith has the punitive effect of making a transferee forfeit something for which it already paid.

Fraudulent transfer law is not designed to be punitive. Rather, it is intended to prevent "unjust diminution" of the property available to satisfy creditor claims. 1 Garrard Glenn, FRAUDULENT CONVEYANCES AND PREFERENCES § 289, at 195 (rev. ed. 1940). In light of that purpose, it is "hornbook law" that "'a conveyance cannot be fraudulent as to creditors . . . if the conveyance does not deplete or otherwise diminish the value of the assets of the debtor's estate remaining available to creditors.'" *Lippe* v. *Bairnco Corp.*, 249 F. Supp. 2d 357, 375 (S.D.N.Y. 2003) (quoting 30 N.Y. Jur. 2d Creditors' Rights & Remedies § 305).

The Trustee's proposed "inquiry notice" test is untethered from those principles. It would require banks, lenders and securities dealers, for their self-protection, to investigate *all* transferors, including those to whom they are strangers or for whom they act as intermediaries. If they fail to meet that impossible burden, those market participants would be at risk of having to return transfers even when they provided *full value* in exchange (by extending credit, purchasing assets or otherwise).

The Trustee's proposed test would also sit uneasily with Section 546(e) of the Bankruptcy Code, the "safe harbor" provision (applied in the Madoff case[4]) that

---

[4] *See Picard* v. *Ida Fishman Revocable Trust (In re Bernard L. Madoff Inv. Secs. LLC)*, 773 F.3d 411 (2d Cir. 2014).

prohibits avoidance of transfers to or from protected parties (including financial institutions) in connection with securities contracts. 11 U.S.C. § 546(e). By its terms, Section 546(e) does not apply to actual-intent fraudulent transfers under Section 548(a)(1) of the Code. But the policies underlying Section 546(e) are nonetheless instructive: Congress enacted Section 546(e) to protect the finality of securities transactions and to minimize the "displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." *Enron Creditors Recovery Corp.* v. *Alfa, S.A.B. de C.V.*, 651 F.3d 329, 334 (2d Cir. 2011). Requiring dealers and banks to investigate all transfers and transferors — even when they give value, and even when they have no culpability in fraud — would necessarily disrupt the stability and predictability of markets. As discussed, however, such disruption is not necessary to vindicate the policies of fraudulent transfer law.

C. Statutory History

The term "good faith" did not originate in federal bankruptcy law. Rather, it was imported into federal bankruptcy law from uniform state statutes governing fraudulent conveyances.

Specifically, the Uniform Fraudulent Conveyance Act (UFCA), promulgated in 1918, states that "fair consideration" is given for property when, "in exchange for such property, or obligation, as a fair equivalent therefor, *and in good faith*, property is conveyed or an antecedent debt is satisfied." UFCA § 3(a) (emphasis added). In its constructive fraudulent conveyance provisions, the UFCA provides for avoidance of transfers made without "fair

consideration" while the debtor is insolvent or undercapitalized. UFCA §§ 4-6. Separately, and similar to Sections 548(c) and 550(b), Section 9 of the UFCA prevents recovery of a transfer to "a purchaser for fair consideration without knowledge of the fraud." UFCA § 9.

The "good faith" standard, in its current form, came into federal bankruptcy law in 1978, when Congress enacted the Bankruptcy Code. The fraudulent transfer provisions of the Bankruptcy Code have been described, by an author of the Bankruptcy Code,[5] as the "new federal enactment of the Uniform Fraudulent Conveyance Act." Richard B. Levin, *An Introduction to the Trustee's Avoiding Powers*, 53 Am. Bankr. L.J. 173, 180 (1979).[6] Authorities interpreting the UFCA, including "good faith," are thus highly probative.

The UFCA case law does *not* support an "inquiry notice" or similar objective standard. As explained in a 1983 article reviewing the law on good faith under the UFCA,[7] "[u]nder early interpretations of the Act,

---

[5] *See* https://jenner.com/people/RichardLevin (last visited Oct. 31, 2020) ("[a]n author of the 1978 US Bankruptcy Code").

[6] Provisions of the UFCA were initially incorporated into federal bankruptcy law as part of the Chandler Act enacted in 1938. *See id.* at 179-80; 5 *Collier on Bankruptcy* ¶ 548.01[2] (16th ed. 2020).

[7] In 1984, the Uniform Law Commission replaced the UFCA with the Uniform Fraudulent Transfer Act (UFTA), and many states adopted the UFTA. New York, unlike most states, retained the UFCA until it recently enacted the Uniform Voidable Transactions

the good-faith requirement played a subsidiary role in relation to the fair-equivalence requirement," and courts "explicitly considered good faith only when an examination of values proved fruitless." Note, *Good Faith and Fraudulent Conveyances*, 97 Harv. L. Rev. 495, 499 (1983).

Over time, however, courts began to consider factors beyond value in assessing good faith, including the defendant's "'(1) honest *belief* in the propriety of the activities in question; (2) no *intent* to take unconscionable advantage of others; and (3) no *intent* to, or *knowledge* of the fact that the activities in question will hinder, delay, or defraud others.'" *Id.* (emphasis added) (quoting *Tacoma Ass'n of Credit Men* v. *Lester*, 433 P.2d 901, 904 (Wash. 1967), and citing additional cases)). But as shown by each the factors listed above, "[o]f course the inquiry remains subjective . . . in the sense that the transferee's intentions are examined." *Good Faith and Fraudulent Conveyances,* 97 Harv. L. Rev. at 509.

Professor Garrard Glenn, a leading authority on fraudulent conveyance law, adopted a similar view of good faith in his widely-cited 1940 treatise, stating that "[i]t comes always to a question of the grantee's good faith *as distinct from mere negligence*" and that "[t]here must be a conscious turning away from the subject" to show bad faith. 1 G. Glenn, FRAUDULENT CONVEYANCES AND PREFERENCES § 304, at 488 (rev. ed. 1940)) (emphasis added)

Notably, under the UFCA, significant case law held that *participation* in the debtor's fraud, rather

---

Act (UVTA). *See* N.Y. Debt. & Cred. Law §§ 270–281 (2019).

than just knowledge, was necessary to show bad faith. *See, e.g.*, *Gilmer* v. *Woodson*, 332 F.2d 541, 547 (4th Cir. 1964) (good faith not lacking unless transferee "knowingly participated in the debtor-transferor's purpose to defeat other creditors"); *Smith* v. *Whitman*, 189 A.2d 15, 20 (N.J. 1963) ("good faith is lacking if the transferee knowingly aids the debtor in the debtor's purpose to secrete assets for the debtor's enjoyment"). Consistent with that case law, an Official Comment to the UFCA equated bad faith with "*collusion* on the part of the grantee." *Report of the Committee on Uniform State Laws*, 5 A.B.A. J. 481, 493 n.1 (1919) (emphasis added).

As reflected by those authorities, prior to the enactment of the Bankruptcy Code in 1978, there was broad support for the proposition that a challenge to "good faith," as used in the uniform state law on which Sections 548(c) and 550(b)(1) of the Code were based, required knowing participation in the debtor's fraud or, at the very least, guilty knowledge on the part of the transferee.

D. Recent Case Law

As the district court recognized, since the enactment of the Bankruptcy Code in 1978, various cases have adopted an "inquiry notice" standard, under which — as this Court has explained in dicta — a transferee's good faith turns on whether the transferee has information putting it on inquiry notice of the debtor's fraud or insolvency. *Marshall* v. *Picard (In re BLMIS LLC)*, 740 F.3d 81, 88 (2d Cir. 2014); SPA5, 6 n.2.

Overall, however, the case law on good faith has been marked by "lack of clarity if not outright

confusion."[8] More than 10 years ago, in two Ponzi-scheme cases, courts in this Circuit adopted an objective "inquiry notice" test.[9] On the other hand, in a 2011 decision arising out of the Marc Dreier Ponzi scheme, Bankruptcy Judge Glenn questioned the "inquiry notice" standard. Foreshadowing the decisions in this case, Judge Glenn explained that — unlike the prime broker defendant in the Manhattan Investment Fund Ponzi-scheme case, where the court applied an objective test in evaluating transfers to the prime broker Bear Stearns — the hedge fund investors defrauded by Dreier "do not appear to have owed a duty to anyone (other than perhaps their own investors) to investigate Dreier's fraud." *Gowan* v. *Patriot Grp., LLC (In re Dreier LLP)*, 452 B.R. 391, 449 (Bankr. S.D.N.Y. 2011). The court went on to suggest, citing Professor Glenn's treatise as well as a decision of this Court construing the UFCA, that the defendants would lack good faith if they "'consciously avoided' facts" showing a high likelihood of fraud. *Id.* at 449-50 (quoting *HBE Leasing Corp.* v. *Frank*, 48 F.3d 623, 637 (2d Cir. 1995) and Glenn, *supra* § 304).[10]

---

[8] *Christian Brothers High Sch. Endowment* v. *Bayou No Leverage Fund, LLC (In re Bayou Grp., LLC)*, 439 B.R. 284, 309 (S.D.N.Y. 2010).

[9] *In re Bayou Grp.*, 439 B.R. at 312-13; *Bear, Stearns Secs. Corp.* v. *Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1, 22-23 (S.D.N.Y. 2007).

[10] In a subsequent decision arising out of the Dreier fraud, a different bankruptcy judge concluded that "conscious turning away" is the test for lack of "good faith" under the UFCA, but concluded that "inquiry notice" is the standard under section 548(c)

Outside this Circuit, the cases have also diverged. Some courts have combined objective and subjective elements in their tests.[11] Other courts have adopted an objective test, but have not provided a good rationale for doing so. For example, in *Jobin* v. *McKay (In re M & L Business Machine Co.)*, 84 F.3d 1330 (10th Cir. 1996), a Ponzi scheme case that has been called "the one case that sets out an explanation" for the objective good faith test,[12] the court stated "[i]t is

---

of the Bankruptcy Code. *Gowan* v. *Westford Asset Mgmt. LLC (In re Dreier LLP)*, 462 B.R. 474, 491-92 (Bankr. S.D.N.Y. 2011). But there is no sound basis to conclude that the same words mean one thing in the UFCA and something else in the Code provisions adapted from the UFCA.

[11] *See Templeton* v. *O'Cheskey (In re Am. Hous. Found.)*, 785 F.3d 143, 164 (5th Cir. 2015) (noting the parties' agreement on an inquiry notice standard, but remanding for fact-finding because "[t]he most important set of questions [in the good faith inquiry] concerns the transferee's state of mind" (alteration in original) (quoting *Jimmy Swaggart Ministries* v. *Hayes (In re Hannover Corp.)*, 310 F.3d 796, 799 (5th Cir. 2002)); *Goldman* v. *Capital City Mortg. Corp (In re Nieves)*, 648 F.3d 232, 239 (4th Cir. 2011) (adopting mixed test: "[u]nder the subjective prong, a court looks to 'the honesty' and 'state of mind' of the party acquiring the property. Under the objective prong, a party acts without good faith by failing to abide by routine business practices.").

[12] Paul Sinclair, *The Sad Tale of Fraudulent Transfers (Part II): When Did Ponzi Preferences*

the ultimate aim of the *preference law* in the Bankruptcy Code to insure that all creditors receive an equal distribution from the available assets of the debtor." *Id.* at 1337 (emphasis added). But as explained in Point II, preferences are governed by a different section of the Bankruptcy Code, Section 547, and the goals of preference law are different from those of fraudulent transfer law. Moreover, since *Jobin* involved guaranteed returns of 120% per year on some investments and 468% per year on others, *id.* at 1338-39, the court would likely have found bad faith under a subjective standard as well.[13]

By contrast, other courts have adopted a subjective test similar to the one adopted in this case. The most expansive decision in that category is *Meoli* v. *Huntington Nat'l Bank (In re Teleservices Group, Inc.)*, 444 B.R. 767 (Bankr. W.D. Mich. 2011). In that case, a trustee sued a bank to recover payments made by the debtor on a revolving credit line using fraudulently obtained funds. 444 B.R. at 774-88. As part of a thorough review of the good faith case law, the court demonstrated that the leading appellate decision applying an inquiry-notice test — *Hayes* v. *Palm Seedlings Partners (In re Agric. Research & Tech. Group, Inc.)*, 916 F.2d 528 (9th Cir. 1990) —

Morph into Fraudulent Transfers?, 28 Am. Bankr. Inst. J. 44, 66-67 (May 2009).

[13] Craig T. Lutterbein, *"Fraud and Deceit Abound" but Do the Bankruptcy Courts Really Believe Everyone Is Crooked: The* Bayou *Decision and the Narrowing of "Good Faith,"* 18 Am. Bankr. Inst. L. Rev. 405, 437-44 (2010) (making similar observation as to other leading cases adopting the objective standard).

relied on a Supreme Court decision called *Shauer* v. *Alterton*, 151 U.S. 607 (1894). *Shauer*, however, interpreted a Dakota Territory statute that expressly imputed constructive knowledge to those who did not exercise "reasonable diligence" when faced with facts that would put "a prudent man" on "inquiry." *See id.* at 618; *accord* Paul Sinclair, 28 Am. Bankr. Inst. J. at 79-80. Notably, in defending the inquiry notice standard in this Court, SIPC relies heavily on the *Shauer* case (SIPC Br. 8) — even though, as shown in *Teleservices*, the statute at issue in *Shauer* itself imposed a "reasonable diligence" test rather than the good faith test in the UFCA and the Bankruptcy Code.

The *Teleservices* court ultimately concluded that the modern "inquiry notice" test represents an unjustified departure from the traditional understanding of the term "good faith," which focused on a person's state of mind and "honesty and integrity." 444 B.R. at 815. The court further concluded that, because "actual knowledge" of fraud is difficult to prove, "willful blindness" may be sufficient to show bad faith. *Id.* at 814-15.[14]

In deciding the good faith issue, this Court has the benefit of a clean slate, and can evaluate the competing approaches set forth in prior cases. For all the reasons explained here, decisions such as

---

[14] On appeal, the Sixth Circuit, after noting that courts have "struggled" to define good faith, concluded that the test applied by the bankruptcy court was "not erroneous." *Meoli* v. *The Huntington Nat'l Bank*, 848 F.3d 716, 734 (6th Cir. 2017).

Teleservices are far more compelling than the cases applying an objective test.

POINT II

THE DISTRICT COURT CORRECTLY ADOPTED A SUBJECTIVE GOOD FAITH TEST IN THE CONTEXT OF A LOAN REPAYMENT.

Regardless of whether this Court adopts the district court's interpretation of "good faith" for all purposes, there is an overwhelmingly strong legal basis to adopt the district court's subjective test in the circumstances presented. Under longstanding doctrine, lenders such as Citibank — which are sued for accepting repayment of an indisputably valid loan — do not act in bad faith merely for receiving a preferential debt repayment, at least in the absence of knowing participation in the debtor's fraud.

This doctrine is based on a fundamental distinction in the Bankruptcy Code and state law: namely, the distinction between *preferences*, on the one hand, and *fraudulent transfers*, on the other. Section 547 of the Bankruptcy Code, which governs preferential transfers, serves a different purpose than Section 548 of the Code, which governs fraudulent transfers.

As this Court has explained, the basic object of preference law, including the general rule of Section 547 that payments to creditors within 90 days of a filing are recoverable, is to ensure "equality of distribution among creditors." *Lawson* v. *Ford Motor Co. (In re Roblin Indus., Inc.)*, 78 F.3d 30, 40 (2d Cir. 1996) (quoting H.REP. No. 595, 95th Cong., 1st Sess. 177-78 (1977), *reprinted in* U.S.Code Cong. & Admin.

News 5963, 6138). In contrast, "[t]he basic object of fraudulent conveyance law," including Section 548 of the Bankruptcy Code, "is to see that the debtor uses his limited assets to satisfy *some* of his creditors" as opposed to shareholders or other insiders. *Sharp Int'l Corp.* v. *State St. Bank & Trust Co. (In re Sharp Int'l Corp.)*, 403 F.3d 43, 54 (2d Cir. 2005) (emphasis in original) (quoting *HBE Leasing Corp.*, 48 F.3d at 633).

This distinction between preferential and fraudulent transfers — along with the related principle that recipients of a preference do not act in bad faith, unless they are culpable in fraud — is deeply engrained in the law. The Supreme Court, in a 1909 decision, stated that "[a]n attempt to prefer is not to be confounded with an attempt to defraud, nor a preferential transfer with a fraudulent one." *Coder* v. *Arts*, 213 U.S. 223, 241 (1909) (internal quotation marks omitted). In an earlier decision, the Court held that "in the absence of a law of the forum prohibiting preferences," a conveyance made to a creditor "is valid, though it may operate to bar other creditors from obtaining satisfaction of their debts." *Davis* v. *Schwartz*, 155 U.S. 631, 639 (1895). As the Court explained, "the preferred creditors receive no more than they are entitled by law to have, and the fact that they know that other creditors will suffer by their preference *does not show a want of good faith*." *Id.* at 640 (emphasis added).

More recent cases have reaffirmed the distinction between preferences and fraudulent transfers and applied a broad definition of good faith in the context of loan repayments. In *Boston Trading Group, Inc.* v. *Burnazos*, 835 F.2d 1504 (1st Cir. 1987), now-Justice Breyer explained that, unlike the preference statute

in the Bankruptcy Code, "the intent of fraudulent conveyance statutes is not to provide equal distribution of the estates of debtors among their creditors." *Boston* Trading, 835 F.2d at 1509 (quoting 1 G. Glenn, FRAUDULENT CONVEYANCES AND PREFERENCES, § 289 (rev. ed. 1940)). Accordingly, the First Circuit held that the repayment of a debt to a non-insider was not subject to avoidance as a (constructive or intentional) fraudulent conveyance, despite the creditor's knowledge that it was being repaid with the proceeds of fraud. Construing the term "good faith" in the UFCA as a component of "fair consideration," the Court concluded that lack of good faith requires *culpability* in the debtor's fraud: "To find a lack of 'good faith' where the transferee does not participate in, but only knows that the debtor created the other debt through some form of, dishonesty is to void the transaction because it amounts to a kind of 'preference.'" 835 F.2d at 1510-12.

In its 2005 decision in *Sharp International*, this Court embraced and applied the reasoning of *Boston Trading*. In that case, after making a loan to the borrower, Sharp International, State Street became suspicious of the borrower's activities. State Street demanded repayment, and Sharp International complied using funds that it fraudulently procured from other creditors. The trustee in Sharp International's bankruptcy proceeding sought to avoid the repayment to State Street under New York's version of the UFCA. In advancing a claim for constructive fraudulent conveyance, the trustee acknowledged "that the payment at issue discharged an antecedent debt and was made for a 'fair equivalent,'" but contended that "fair consideration

[was] lacking because State Street did not receive the payment in 'good faith.'" *Sharp Int'l*, 403 F.3d at 54.

This Court rejected the trustee's position, concluding that "[t]he decisive principle in this case is that a *mere preference between creditors does not constitute bad faith*," at least in situations where the transferee is not an insider of the debtor. *Id.* (emphasis added). The Court explained further that "[a] conveyance which satisfies an antecedent debt made while the debtor is insolvent is neither fraudulent nor otherwise improper, even if its effect is to prefer one creditor over another." *Id.* at 54-55.

In *Sharp International*, therefore, this Court held that — when a lender receives repayment of a loan — it will not lack "good faith" absent knowing participation in the debtor's misconduct. *Id.* at 55-56. This approach coheres with common-law principles, under which a creditor that knowingly finances a fraudulent enterprise may be said to aid and abet such a scheme; on the other hand, a creditor that just accepts repayment of a valid debt does not violate a common-law duty.[15]

Sharp International is squarely on point. The defendant here, Citibank, made loans to a Madoff customer and received repayment of the loans. At most, therefore, Citibank received a preference vis-à-vis other creditors of the customer (or, on a broader level, other creditor victims of the Madoff fraud). There is no sound basis to impose liability on Citibank

---

[15] *Sharp Int'l*, 403 F.3d at 51 (under New York law, State Street's "demand for repayment of a bona fide debt is not a corrupt inducement that would create aider and abettor liability").

Case 20-1333, Document 136, 11/12/2020, 2973137, Page34 of 42

in this case when, as this Court correctly held, State Street had no liability in *Sharp International*.

The fact that *Sharp International* and *Boston Trading* construed "fair consideration" under the UFCA's constructive fraudulent conveyance provisions — rather than Section 550(b) or 548(c) of the Bankruptcy Code — does not provide a basis for a distinction. As discussed above, the Bankruptcy Code's "good faith" language is drawn from the UFCA's "fair consideration" provision, which encompasses good faith. Moreover, the logic of *Sharp International* and *Boston Trading* — namely, that fraudulent transfer law is not designed to police merely preferential payments to valid creditors — applies under the Bankruptcy Code as it does under the UFCA. Under the Code and the UFCA alike, the policy underlying fraudulent transfer law — to ensure that the debtor "uses his limited assets to satisfy *some*" creditors, *Sharp Int'l*, 403 F.3d at 54 — is not served by imposing an objective good-faith test on non-insider creditors, such as Citibank, that simply receive repayment of an amount indisputably owed.

POINT III

FEDERAL SECURITIES LAW SUPPORTS A SUBJECTIVE GOOD FAITH TEST AND IMPOSING THE PLEADING BURDEN ON THE TRUSTEE.

The Trustee's powers in this case derive from SIPA, 15 U.S.C. § 78bbb, which is part of the Securities Exchange Act of 1934. *See In re Bernard L. Madoff Inv. Sec. LLC*, 773 F.3d at 418; *SEC* v. *Packer, Wilbur & Co.*, 498 F.2d 978, 984-85 (2d Cir. 1974).

In the context of a SIPA liquidation, where the governing statute is a part of federal securities law, there is a particularly strong basis for adopting the district court's test for good faith and rejecting an inquiry notice standard. Even in cases adopting an objective (or mixed) good faith test, courts have concluded that a transferee's conduct must be measured against the "customary practices of the industry." *E.g.*, *In re Nieves*, 648 F.3d at 238. Indeed, the Trustee himself has contended that, in evaluating good faith, "[t]he reasonableness of investor conduct . . . is determined based on the standards of that industry." Trustee Br. 38.

In the heavily-regulated securities industry, Congress has legislated the governing commercial standard. As the Supreme Court has explained, the securities laws (of which SIPA is a part) impose "specified civil liabilities" so as to promote uniform "standards of honesty and fair dealing." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 195 (1976) (citing H.R. REP. No. 85, 73d Cong., 1st Sess., 1-5 (1933)). The securities laws comprise "the careful plan that Congress has enacted for regulation of the securities markets." *Chiarella* v. *U.S.*, 445 U.S. 222, 235 (1980).

In the securities industry, investors rely on securities regulators and uniform securities law to prevent and police fraud, including by broker-dealers such as BLMIS. As the district court noted, "it is undisputed that a securities investor has no inherent duty to inquire about his stockbroker." *Katz*, 462 B.R. at 455. Rather, market participants are liable for securities fraud only if they act with "willful or reckless disregard for the truth." *Rolf* v. *Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir. 1978)

(quoting *Lanza* v. *Drexel & Co.*, 479 F.2d 1277, 1306 (2d Cir. 1973) (en banc)). As the Supreme Court has held, for civil liability to be imposed on a participant in the securities market, "proof of *more* than negligent nonfeasance" is "a precondition." *Hochfelder*, 425 U.S. at 215 (emphasis added). Liability instead requires that "'the danger was either known to the defendant or so obvious that the defendant must have been aware of it[,]'" a standard comparable to willful blindness. *See Rothman* v. *Gregor*, 220 F.3d 81, 90 (2d Cir. 2000) (quoting *Rolf*, 570 F.2d at 47).

The Trustee insists that the securities laws do not uniformly demand scienter and that the district court was wrong to treat Section 10(b) of the Exchange Act as the primary source of norms in the securities industry. *See* Trustee Br. 39-40. But Section 10(b) serves as the "'catchall' antifraud provision" in securities law. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 382 (1983). In contrast, the sections that the Trustee points to — Sections 11, 12(a)(2) and 17(a)(2) — are carve-outs to that general rule that apply only in narrow circumstances.[16] Indeed, every provision of the 1934 Act that creates civil liability not directed to a specific class of individuals "contains a state-of-mind condition requiring something more than negligence." *Hochfelder*, 425 U.S. at 209 n.28.

---

[16] See *Huddleston*, 459 U.S. at 382 ("[a]lthough limited in scope, Section 11 places a relatively minimal burden on a plaintiff"); In *re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 359-60 (2d Cir. 2010) (contrasting Sections 11 and 12(a)(2) which "apply more narrowly" than Section 10(b)).

Importantly, lack of "good faith" is a basis for liability under several sections of the Exchange Act — and the statute has been read to impose a *subjective* standard much like the one being attacked by the Trustee on this appeal. For example, Section 20(a) imposes liability on a control person "unless [he or she] acted in good faith," 15 U.S.C. § 78t(a). "To establish a prima facie case of control person liability," plaintiff must allege "that the defendant was, in some meaningful sense, a *culpable participant* in the controlled person's fraud." *In re Bernard L. Madoff Inv. Sec. LLC*, 818 F. App'x 48, 56 (2d Cir. 2020) (emphasis added). Section 18(a), which imposes liability "unless the person sued shall prove that he acted in good faith," 15 U.S.C. § 78r(a), has likewise been interpreted to require 'scienter,'" or a "mental state embracing intent to deceive, manipulate, or defraud." *Dekalb Cnty. Pension Fund* v. *Transocean Ltd.*, 817 F.3d 393, 406-07 (2d Cir. 2016) (internal citations and quotations omitted). It would be incongruous for the same phrase, "good faith," to have one meaning in Sections 20(a) and 18(a) of the Securities Exchange Act but an entirely different meaning in the context of the SIPA liquidation, which is governed by a statute (SIPA) that is treated as part of that Act.

Section 20(a), and the case law interpreting it, are also probative insofar as they impose the burden of pleading and proof on the plaintiff to show lack of good faith. *See In re Bernard L. Madoff*, 818 F. App'x at 55 (summary order) (plaintiff must show, as part of *prima facie* case, that "defendant was, in some meaningful sense, a culpable participant in the

controlled person's fraud").[17] Section 550(b) of the Bankruptcy Code, like Section 20(a) and unlike Section 18(a) of the Securities Exchange Act, does not place the burden on defendants to prove their good faith. Rather, by its terms, it exempts from Section 550(b) any "transferee that takes for value, . . . in good faith, and without knowledge of voidability of the transfer avoided." 11 U.S.C. § 550(b)(1). The statute, accordingly, does not impose the burden of pleading and proof on Citibank any more than the burden would be imposed on a Section 20(a) defendant.

In the SIPA context, imposing the burden of pleading and proof on the Trustee is consistent not only with the text of Section 550(b)(1), but also with procedural norms. As Wright & Miller have explained, "in determining what defenses other than those listed in Rule 8(c) must be pleaded affirmatively, resort often must be had to considerations of policy, fairness, and in some cases probability." *See* 5 Charles Alan Wright & Arthur R. Miller, FEDERAL PRACTICE AND PROCEDURE § 1271 (3d ed. 2020). Generally speaking, "the burden of pleading should be put on the party who will be benefited by establishing a departure from the supposed legal or behavioral norm." *Id; accord, e.g.*, *Bank Melli Iran* v. *Pahlavi*, 58 F.3d 1406, 1409 (9th Cir. 1995).

---

[17] *See also, e.g.*, *SEC* v. *Yorkville Advisors, LLC*, 305 F. Supp. 3d 486, 511 (S.D.N.Y. 2018) ("Among the district courts in this circuit, the weight of well-reasoned authority requires the plaintiff to prove some level of culpable participation" (internal citation and quotation marks omitted)).

Case 20-1333, Document 136, 11/12/2020, 2973137, Page39 of 42

In a SIPA liquidation, where securities investors transact with SEC-registered broker-dealers — or, in the *Citibank* case, where a bank transacts with customers of the broker-dealer — the plaintiff Trustee is the one seeking to establish that investors or their lenders have departed from legal and other norms. Imposing the burden of proof on transferee-investors, under Sections 550(b)(1) and 548(c), would invite abuse and needless cost, in a context where predictability is paramount. For those reasons, and for the non-SIPA-related reasons stated by the parties in their merits briefs, the District Court was correct in imposing the burden of pleading and proof on the Trustee in cases arising out of the Madoff fraud.

CONCLUSION

For the reasons set forth above, the judgment of the bankruptcy court dismissing the Trustee's claims against the defendant-appellees should be affirmed.

Respectfully submitted,

EMIL A. KLEINHAUS
WACHTELL, LIPTON, ROSEN
& KATZ
51 West 52nd Street
New York, New York 10019
(212) 403–1000

Attorneys for Amici Curiae
the Securities Industry and Financial Markets Association and American Bankers Association

November 12, 2020

Of Counsel:

IRA D. HAMMERMAN
KEVIN M. CARROLL
SECURITIES INDUSTRY AND FINANCIAL
MARKETS ASSOCIATION
1101 New York Avenue, N.W.
Washington, D.C. 20005
(202) 962–7382

THOMAS PINDER
AMERICAN BANKERS ASSOCIATION
1120 Connecticut Ave, N.W.
Washington, DC 20036
203-379-8151

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(a)(5) and Local Rule 32.1(a)(4)(A) because it contains 6,964 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) as modified for printed briefs in pamphlet format by Local Rule 32.1(a)(2), and complies with the type style requirements of Fed. R. Civ. P. 32(a)(6), because it has been prepared in a proportionally spaced typeface using Microsoft Word in 12-point Century Schoolbook font.

EMIL A. KLEINHAUS
Attorney for Amici Curiae

November 12, 2020

CERTIFICATE OF SERVICE

I hereby certify that on November 12, 2020, I caused the foregoing *amicus* brief to be filed with the Clerk of the Court for the United States Court of Appeals for the Second Circuit by using the CM/ECF system.

EMIL A. KLEINHAUS
Attorney for Amici Curiae

November 12, 2020