EXHIBIT 7

477 B.R. 504
(Cite as: 477 B.R. 504)

H

United States Bankruptcy Court,
D. Delaware.
In re DBSI, INC., et al., Debtors.
James R. Zazzali, as Trustee for the Debtors' Jointly–Administered Chapter 11 Estates and/or as Litigation Trustee for the DBSI Estate Litigation Trust, Plaintiff,
v.
AFA Financial Group, LLC, et al., Defendants.

Bankruptcy No. 08–12687 (PJW).
Adversary No. 10–54524 (PJW).
Aug. 27, 2012.

Background: Trustee of litigation trust brought adversary proceeding to avoid transfers made by Chapter 11 debtors to more than 100 broker-dealers, and defendants moved to dismiss for failure to state cause of action.

Holdings: The Bankruptcy Court, Peter J. Walsh, J., held that:
(1) allegations in trustee's complaint, regarding commission payments that debtors allegedly made to defendants in order to induce defendants to continue to engage in sales that generated the funds used by debtors to make payments to earlier investors and to continue operate Ponzi scheme, state actual fraudulent transfer claim under both bankruptcy and Idaho law;
(2) trustee stated unjust enrichment claim;
(3) whether alleged preferential payments made by debtors to more than 100 broker-dealer defendants came within "safe harbor" for "settlement payments" could not be decided at motion-to-dismiss stage; and
(4) claim for disallowance of creditors' claims was premature.

Granted in part and denied in part.

West Headnotes

[1] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Complaint to avoid transfer as actually fraudulent to creditors is subject to heightened federal pleading standards for allegations of fraud. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[2] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

While complaint to avoid transfer as actually fraudulent to creditors is subject to heightened federal pleading standards for allegations of fraud, standard is relaxed when complaint is filed by trustee, who inevitably lacks knowledge concerning acts of fraud previously committed against debtor; however, even under this relaxed standard, trustee must allege more than mere legal conclusions and cannot simply repeat elements of fraudulent transfer provision. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[3] Bankruptcy 51 ⚿2726(4)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726 Presumptions
51k2726(4) k. Fraudulent transfers. Most Cited Cases

In proceeding to avoid transfer as actually fraudulent to creditors, bankruptcy court can infer necessary intent from circumstances of case, particularly the presence of "badges of fraud," based upon the following: (1) relationship between debtor and trans-

feree; (2) whether there was consideration for transfer; (3) insolvency or indebtedness of debtor; (4) how much of the debtor's estate was transferred; (5) debtor's reservation of benefits, control, or dominion over property transferred; and (6) secrecy or concealment of transaction. 11 U.S.C.A. § 548(a)(1)(A).

[4] Bankruptcy 51 ⚿2649

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2649 k. Intent of debtor. Most Cited Cases

No single badge of fraud is dispositive in deciding whether challenged transfer was made with actual intent to hinder, delay, or defraud creditors, and bankruptcy court may consider other factors in deciding whether "intent" element of actually fraudulent transfer claim is satisfied. 11 U.S.C.A. § 548(a)(1)(A).

[5] Bankruptcy 51 ⚿2726(4)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726 Presumptions
51k2726(4) k. Fraudulent transfers. Most Cited Cases

Ponzi presumption posits that all payments made by debtor in furtherance of Ponzi scheme are made with actual fraudulent intent, of kind required to avoid transfer as actually fraudulent to creditors. 11 U.S.C.A. § 548(a)(1)(A).

[6] Bankruptcy 51 ⚿2726(4)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726 Presumptions
51k2726(4) k. Fraudulent transfers. Most Cited Cases

Bankruptcy 51 ⚿2726.1(3)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726.1 Burden of Proof
51k2726.1(3) k. Fraudulent transfers. Most Cited Cases

Ponzi presumption does not relieve trustee of the burden, in proceeding to avoid allegedly fraudulent transfers by one involved in Ponzi scheme, to show that transfers at issue were made "in furtherance of" Ponzi scheme. 11 U.S.C.A. § 548(a)(1)(A).

[7] Bankruptcy 51 ⚿2649

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2649 k. Intent of debtor. Most Cited Cases

Even when plaintiff has alleged existence of a broad, fraudulent scheme, court must focus precisely on specific transaction or transfer sought to be avoided in order to determine whether that transaction falls within statutory parameters of actually fraudulent transfer. 11 U.S.C.A. § 548(a)(1)(A).

[8] Bankruptcy 51 ⚿2649

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2649 k. Intent of debtor. Most Cited Cases

Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Bankruptcy 51 ⚿2726(4)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726 Presumptions
51k2726(4) k. Fraudulent transfers. Most Cited Cases

Bankruptcy 51 ⚿3570

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3570 k. Execution and performance. Most Cited Cases

Allegations in complaint filed by trustee for litigation trust, regarding the commission payments that Chapter 11 debtors allegedly made to defendants in order to induce defendants to continue to engage in sales that generated the funds used by debtors to make payments to earlier investors and to continue operating their business at time when they were allegedly insolvent and unable to continue operating business other than as Ponzi scheme, sufficiently alleged both existence of Ponzi scheme and that challenged payments were made in furtherance thereof, so as to trigger Ponzi presumption and satisfy intent requirement for stating actual fraudulent transfer claim under bankruptcy fraudulent transfer statute. 11 U.S.C.A. § 548(a)(1)(A).

[9] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Allegations that were sufficient to trigger Ponzi presumption, so as to state cause of action to avoid transfers as actually fraudulent to creditors under bankruptcy fraudulent transfer statute, were likewise sufficient to state claim to avoid same transfers in exercise of strong-arm powers as actually fraudulent to creditors under Idaho law. 11 U.S.C.A. § 544(b); West's I.C.A. §§ 55–906, 55–913(1)(a).

[10] Implied and Constructive Contracts 205H ⚿3

205H Implied and Constructive Contracts
205HI Nature and Grounds of Obligation
205HI(A) In General
205Hk2 Constructive or Quasi Contracts
205Hk3 k. Unjust enrichment. Most Cited Cases

To succeed on unjust enrichment claim under Idaho law, plaintiff must show: (1) a benefit conferred on defendant by plaintiff; (2) appreciation by defendant of such benefit; and (3) acceptance of benefit under circumstances which would make it inequitable for defendant to retain benefit without payment to plaintiff of the value thereof.

[11] Implied and Constructive Contracts 205H ⚿3

205H Implied and Constructive Contracts
205HI Nature and Grounds of Obligation
205HI(A) In General
205Hk2 Constructive or Quasi Contracts
205Hk3 k. Unjust enrichment. Most Cited Cases

"Inequity" exists, of kind required to support unjust enrichment claim under Idaho law, if transaction is inherently unfair.

[12] Bankruptcy 51 ⚿2162

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2162 k. Pleading; dismissal. Most Cited Cases

Bankruptcy 51 ⚿3570

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3570 k. Execution and performance. Most Cited Cases

Trustee for litigation trust was entitled to plead claim for unjust enrichment in the alternative, prior to determination of whether there were valid contracts between Chapter 11 debtor and transferees.

[13] Implied and Constructive Contracts 205H ⚷55

205H Implied and Constructive Contracts
205HI Nature and Grounds of Obligation
205HI(D) Effect of Express Contract
205Hk55 k. In general. Most Cited Cases

Under Idaho law, it is only when express agreement is found to be enforceable is court precluded from applying equitable doctrine of unjust enrichment in contravention of express contract.

[14] Bankruptcy 51 ⚷3570

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3570 k. Execution and performance. Most Cited Cases

Implied and Constructive Contracts 205H ⚷81

205H Implied and Constructive Contracts
205HII Actions
205HII(B) Pleading
205Hk81 k. Declaration, complaint, or petition. Most Cited Cases

Allegations in complaint filed by trustee of litigation trust, regarding enrichment of defendants as result of payments that debtors, as operators of alleged Ponzi scheme, collected from downstream investors, sufficiently alleged plausible unjust enrichment scheme, that trustee would be allowed to pursue through further development of factual record.

[15] Bankruptcy 51 ⚷2721

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2721 k. In general. Most Cited Cases

Bankruptcy 51 ⚷3570

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3570 k. Execution and performance. Most Cited Cases

Whether alleged preferential payments made by Chapter 11 debtors to more than 100 broker-dealer defendants came within "safe harbor" for "settlement payments" could not be decided at motion-to-dismiss stage, where court could not determine, based solely on allegations in litigation trustee's complaint, that payments fell within statute's parameters. 11 U.S.C.A. §§ 546(e), 547(b).

[16] Bankruptcy 51 ⚷2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Bankruptcy 51 ⚷3570

51 Bankruptcy
51XIV Reorganization
51XIV(B) The Plan
51k3570 k. Execution and performance. Most Cited Cases

Trustee for litigation trust could not state plausible claim for avoidance of unauthorized postpetition transfers absent allegation that any transfers were made subsequent to commencement of debtors' Chapter 11 cases. 11 U.S.C.A. § 549.

[17] Bankruptcy 51 ⚷2923

51 Bankruptcy
51VII Claims
51VII(E) Determination
51k2923 k. Objections generally; time, form, and sufficiency; pleading. Most Cited Cases

Claim for disallowance of creditors' claims on ground that they were transferees on avoidable transfers and had not turned property over or paid its value was still premature before trustee had obtained judgment against creditors, and before creditors had even filed proofs of claim. 11 U.S.C.A. § 502(d).

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MEMORANDUM OPINION

PETER J. WALSH, Bankruptcy Judge.

This opinion concerns the motion to dismiss this adversary proceeding ("the Motion") filed by certain defendants (the "Movants").[FN1] (Doc. # 123.) For the reasons described below, I will deny the Motion in part and grant it in part.

FN1. Movants are listed on Exhibit I to the Motion. (Doc. # 123.)

Background

This adversary proceeding arose in the chapter 11 bankruptcy cases of DBSI, Inc. ("DBSI") and numerous of its affiliates (collectively, "Debtors"), filed in November 2008. DBSI Securities Corporation ("DBSI Securities"), a DBSI affiliate, filed on November 10, 2008. The history of the DBSI bankruptcy cases has been extensively chronicled in prior decisions from this Court [FN2], so only a brief summary of ***508** the facts relating to this adversary will be provided here.

FN2. *See, e.g., Zazzali v. 1031 Exchange Grp., LLC,* 467 B.R. 767, 769–70 (Bankr.D.Del.2012).

This action was commenced by James R. Zazzali, Litigation Trustee for the DBSI Estate Litigation Trust ("Trustee") on November 4, 2010. (Doc. # 1.) The complaint (the "Complaint") asserts causes of action for the avoidance and recovery of actually fraudulent, preferential, and post-petition transfers pursuant to 11 U.S.C. §§ 544, 547, 548, 549, 550, 551, and applicable state [FN3] fraudulent transfer law; unjust enrichment; and disallowance of claims pursuant to 11 U.S.C. § 502(d). Over 100 broker-dealer defendants are named in the action. The identities and residences of the defendants are listed on Exhibit A to the Complaint. Exhibit B lists numerous transfers (the "Transfers") made by DBSI Securities to the defendants, and includes the amount, date, and check number for each Transfer.

FN3. Trustee has asserted claims under Idaho Code §§ 55–906, 55–913, 55–916, and 55–917.

Movants filed this Motion to dismiss the Complaint in its entirety for failure to state a claim upon which relief can be granted, pursuant to Fed.R.Civ.P. 12(b)(6). After briefing from the parties, this matter is ripe for decision.

Jurisdiction

This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 157 and 1334. This proceeding involves core matters under § 157(b)(2)(B), (F), (H), and (O).

Standard of Review

In order to survive a motion to dismiss under Rule 12(b)(6), "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). Under the pleading requirements imposed by Fed.R.Civ.P. 8(a) [FN4], the plaintiff must provide more than "labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S. at 555, 127 S.Ct. 1955. Rather, "factual allegations must be enough to raise a right to relief above the speculative level." *Id.* *See also Fowler v. UPMC Shadyside*, 578 F.3d 203, 210 (3d Cir.2009) ("To prevent dismissal, all civil complaints must now set out 'sufficient factual matter' to show that the claim is facially plausible. This then 'allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.' ") (quoting *Iqbal*, 556 U.S. at 678, 129 S.Ct. 1937). The court will "accept all factual allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine whether, under any reasonable reading of the complaint, the plaintiff may be entitled to relief." *Phillips v. Cnty. of Allegheny*, 515 F.3d 224, 233 (3d Cir.2008).

> FN4. Rule 8(a) provides that a complaint "must contain: (1) a short and plain statement of the grounds for the court's jurisdiction, unless the court already has jurisdiction and the claim needs no new jurisdictional support; (2) a short and plain statement of the claim showing that the pleader is entitled to relief; and (3) a demand for the relief sought, which may include relief in the alternative or different types of relief."

Discussion

Count One: Avoidance of Actually Fraudulent Transfers under 11 U.S.C. § 548(a)(1)(A), 550, and 551

[1][2] A trustee may avoid a transfer "made with actual intent to hinder, delay or defraud" creditors, provided that the transfer was made within two years before the petition date. ***509**11 U.S.C. § 548(a)(1)(A). Actions to avoid actually fraudulent transfers under § 548(a)(1)(A) are subject to the Fed.R.Civ.P. 9(b) heightened standard of pleading. *Official Comm. of Unsecured Creditors of Fedders N. Am. v. Goldman Sachs Credit Partners (In re Fedders N. Am., Inc.)*, 405 B.R. 527, 544 (Bankr.D.Del.2009). Rule 9(b) requires a plaintiff bringing a cause of action for fraud to "state with particularity the circumstances constituting fraud or mistake." This standard is relaxed where the plaintiff is a trustee in bankruptcy, because "of the trustee's 'inevitable lack of knowledge concerning acts of fraud previously committed against the debtor, a third party.' " *Id.* (citing *Schwartz v. Kursman (In re Harry Levin, Inc. t/a Levin's Furniture)*, 175 B.R. 560, 567 (Bankr.E.D.Pa.1994)). Nonetheless, even under the more relaxed Rule 8(a) standard, the plaintiff must provide more than mere legal conclusions and cannot simply repeat the elements of the cause of action. *Mervyn's LLC v. Lubert–Adler Grp. IV (In re Mervyn's Holdings, Inc.)*, 426 B.R. 488, 494 (Bankr.D.Del.2010) (citing *Twombly*, 127 S.Ct. at 1964–65).

[3][4] Because of the difficulty in proving actual fraudulent intent, the court can infer the necessary intent from the circumstances of the case, particularly the presence or absence of "badges of fraud." *Fedders*, 405 B.R. at 545. The traditional badges of fraud include (but are not limited to):

(1) the relationship between the debtor and the transferee;

(2) consideration for the conveyance;

(3) insolvency or indebtedness of the debtors;

(4) how much of the debtor's estate was transferred;

(5) reservation of benefits, control or dominion by the debtor over the property transferred; and

(6) secrecy or concealment of the transaction.

Id. No single badge of fraud is dispositive, and the court may consider other factors. *Id.*

Trustee pleads that the collective DBSI enterprise was insolvent at the time of the Transfers. Specifically, Trustee makes the following allegations:

• "Marketing, transactional and organizational costs in the TIC [FN5] syndication business prevented [DBSI] from generating sufficient profit to support the DBSI enterprise. At some point in or after 2004, the DBSI enterprise took on the characteristics of a Ponzi scheme, in which the guaranteed returns to the old investors could only be satisfied by the flow of funds from the new investors." (Compl.¶ 20.)

FN5. "TIC" means tenant-in-common.

• "During the four-year period preceding the [p]etition [d]ate (the 'Four Year Period'), the Debtors were facing severe cash shortages and were largely dependent on new investor money to provide cash for operations and to fund payments to prior investors." (Id.¶ 21.)

• DBSI commingled funds among the various entities and routinely transferred cash from one entity to another without regard for the original source of the funds. (*Id.* ¶¶ 22–24.)

• "By late 2006, cash shortages were such an acute problem that management was consumed by the machinations of managing and obtaining cash. From early 2005, management met frequently to address cash-flow needs." (Id.¶ 42.)

***510** • "[D]espite massive flows of cash in and out of [the DBSI enterprise's] accounts, a snapshot on any given day would show either a very meager cash balance or a collective deficit." (Id.¶ 43.)

This Court has previously found that, because the DBSI cases have been substantively consolidated, Trustee need not allege that the particular transferor entity (here, DBSI Securities Corporation) was insolvent. *Zazzali v. Mott (In re DBSI, Inc.)*, 447 B.R. 243, 248 (Bankr.D.Del.2011). As a result, the allegations regarding the insolvency of the DBSI enterprise as a whole are sufficient. From Trustee's assertions listed above, it is plausible that Debtors, including DBSI Securities, were unable to pay their debts as they came due.

Insolvency is the only traditional badge of fraud that Trustee includes in his pleading. But the list of badges of fraud is not exclusive, and so the Court may consider other factors. Here, Trustee raises a number of allegations regarding Debtors' financial condition and their attempts to obscure the true status of their balance sheets. In particular, Trustee alleges that Debtors, including DBSI Securities Corporation, were part of a Ponzi scheme. Trustee alleges that the DBSI enterprise as a whole "took on the characteristics of a Ponzi scheme" around 2004. (Compl.¶ 20.) The scheme was propped up by the sale of TIC interests through both a securities channel and a real estate channel. (*Id.* ¶ 16.) Of the securities channel sales, Trustee alleges:

> DBSI Securities Corporation ("DBSI Securities"), a registered broker-dealer and affiliate of DBSI, marketed and sold the TIC investments on a wholesale basis to various broker-dealers around the United States. The broker-dealers would, in turn, sell the TIC interests to the investing public and receive a commission on those sales.

(Id.) The TIC sales, along with the sale of note, bond, and fund investments, generated the cash flow necessary to keep up the illusion of high returns:

> By generating a continuing influx of cash from new investors through serial bond, note and fund offerings and sales of TIC investments in TIC Properties, the Debtors were able to create and promote the false impression of financial strength and make consistent payments to investors, notwithstanding that the Debtors' [sic] were insolvent at the time.

(Id.¶ 20.) Further, the TIC interests were sold "at substantial mark-ups over the price at which [a DBSI-related special purpose entity] had acquired the TIC Property, yet no value had been added to justify the mark-up." (*Id.* ¶ 25.)

In 2005, "DBSI began to designate a portion of the proceeds received from TIC investors as 'Accountable Reserves,' " which were supposed to be set aside for capital improvements and other expenses related to the TIC Properties purchased. (*Id.* ¶ 27.) These Accountable Reserve funds "were freely commingled with other DBSI funds and used by DBSI and other DBSI entities for general corporate and non-TIC related purposes." (*Id.* ¶ 29.)

[5] Trustee argues that the foregoing allegations establish that DBSI Securities was an integral part of

a widespread Ponzi scheme, and that as a result, the Transfers were made with actual intent to defraud. To reach this conclusion, Trustee relies on the "Ponzi presumption," which posits that "all payments made by a debtor in furtherance of a Ponzi scheme are made with actual fraudulent intent." *Cuthill v. Greenmark, LLC (In re World Vision Entm't, Inc.)*, 275 B.R. 641, 658 (Bankr.M.D.Fla.2002). This Court has previously recognized and applied the presumption in these ***511** DBSI cases. *See, e.g. Zazzali v. 1031 Exch. Grp. (In re DBSI Inc.)*, 478 B.R. 192, 2012 WL 3306995 (Bankr.D.Del. Aug. 14, 2012); *Zazzali v. Swenson (In re DBSI, Inc.)*, Adv. No. 10–54649 (PJW), 2011 WL 1810632, at *4 (Bankr.D.Del. May 5, 2011).

[6][7] Yet the presumption does not relieve Trustee of the burden to show that the Transfers at issue were made "in furtherance of" the Ponzi scheme. *See, e.g., Bear Stearns Secs. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1, 11 (S.D.N.Y.2007) (noting that the court must determine "whether the transfers at issue were related to a Ponzi scheme" before it can apply the Ponzi presumption); *In re Pearlman*, 440 B.R. 569, 575 (Bankr.M.D.Fla.2010) ("To rely on the Ponzi scheme presumption, the trustee must allege the debtors' loan repayments were somehow in furtherance of either the EISA Program or the TCTS Stock Program Ponzi schemes."). This is because even where the plaintiff has alleged the existence of a broad, fraudulent scheme, "the [c]ourt must focus precisely on the specific transaction or transfer sought to be avoided in order to determine whether that transaction falls within the statutory parameters of [an actually fraudulent transfer]." *Bayou Superfund, LLC v. WAM Long/Short Fund II, LP (In re Bayou Grp., LLC)*, 362 B.R. 624, 638 (Bankr.S.D.N.Y.2007). *See also Manhattan Inv. Fund*, 397 B.R. at 11 (noting that "[c]ertain transfers may be so unrelated to a Ponzi scheme that the presumption should not apply"). In sum, Trustee must plead that Debtors were engaged in a Ponzi scheme and that the transfers at issue were related to or in furtherance of the fraudulent scheme.

Trustee has sufficiently alleged the existence of a Ponzi scheme. Specifically, Trustee alleges that the TIC interests were sold at an inflated price unsupported by the value of the underlying property, and that the proceeds from those sales were used for DBSI's operating expenses, including pay-outs to other investors. (Compl.¶¶ 21, 25–29.) This fits the definition of a Ponzi scheme. *See In re Manhattan Inv. Fund*, 397 B.R. at 8 (stating that a Ponzi scheme exists where "money from new investors is used to pay artificially high returns to earlier investors in order to create an appearance of profitability and attract new investors so as to perpetuate the scheme.")

[8] Since he has adequately pled the existence of a Ponzi scheme, Trustee must plead sufficient facts to show that the Transfers were made "in furtherance of" the Ponzi scheme to use the presumption. Movants argue that Trustee has failed in this regard and rely on *Sharp Int'l Corp. v. State Street Bank & Trust Co. (In re Sharp Int'l Corp.)*, 403 F.3d 43 (2d Cir.2005), which held that repayment of a loan by a debtor engaged in fraudulent business practices was not a transfer made with actual intent to defraud where there was no allegation that the lender was involved in the fraud. I find the *Sharp* case to be distinguishable, however. In *Sharp*, there was no allegation that the lender was a part of the fraud; in contrast, here Trustee has alleged that Movants were instrumentalities of the DBSI scheme. The scheme depended upon sales of TIC interests to investors, and Movants were the ones who effected those sales. The Transfers were commissions paid to Movants as reward for their selling efforts. Thus, there is a difference between Movants' role in the Ponzi scheme and the role of a lender who simply loaned money to a fraudulent enterprise.

I find two other cases, ***512***Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, LLC (In re Bayou Grp. LLC)*, 439 B.R. 284 (S.D.N.Y.2010) [herein " *Bayou II* "] and *In re World Vision Entm't, supra*, 275 B.R. 641, to be more instructive. Like Trustee in this case, the trustee in *World Vision* sought to avoid and recover commission fees as actually fraudulent transfers. The debtor ran a Ponzi scheme based on the sale of promissory notes. 275 B.R. at 645. The sales were made by insurance agents acting as brokers, who received a commission in exchange for their efforts. *Id.* at 646. In considering the trustee's avoidance claim, the court held that the transfers were avoidable because they were made in furtherance of the debtor's Ponzi scheme:

> The debtor recruited insurance agents to sell its promissory notes and paid the brokers commis-

> sions, such as those received by the Corporate Defendants in this adversary proceeding, to perpetuate the scheme. Without the brokers, the scheme would have collapsed much earlier. The debtor paid the brokers high commissions to induce them to continue the sales and to keep the cash flowing in. Without question, the debtor paid these commissions with the actual intent to defraud both current and future investors.

Id. at 657. Factually, this situation is identical to the case at hand. *Bayou II,* while not dealing with commissions, underscores that payments made for the purpose of attracting new investors to the scheme are avoidable as actually fraudulent. In that case, the debtors sought to avoid redemption payments made to certain investors. 439 B.R. at 290. The district court in *Bayou II* upheld the bankruptcy court's ruling that the transfers were made with actual fraud. *Id.* at 304. In the process, the court distinguished *Sharp,* noting that the plaintiff in *Sharp* had failed to allege that the loan repayment at issue "was made to 'hinder, delay or defraud' Sharp's creditors—and instead focused on 'the [fraudulent] manner in which Sharp obtained new funding.' " *Id.* at 302. In *Bayou II,* in contrast, the debtors had "specifically pled and demonstrated that the redemption payments hindered, delayed, and defrauded Bayou's creditors, by *inter alia,* forestalling disclosure of the fraudulent scheme." *Id.* Here, Trustee has alleged that the TIC sales were one of the few sources of funds that supported the Ponzi scheme: "By generating a continuing influx of cash from new investors through serial bond, note and fund offerings and sales of TIC investments in TIC Properties, the Debtors were able to create and promote the false impression of financial strength and make consistent payments to investors...." (Compl.¶ 20.) Thus, according to Trustee, the TIC sales were an integral part of the DBSI scheme. The Transfers were made to Movants as commissions for the TIC sales. (Compl.¶ 16.) Taking these two allegations together, Trustee has pled that the Transfers were made in furtherance of the Ponzi scheme, as they were made to keep the flow of investor money coming into DBSI.

Because Trustee has sufficiently alleged facts showing that the DBSI enterprise was a Ponzi scheme and that the Transfers were made in furtherance of the scheme, the Ponzi scheme presumption applies to this case. Consequently, I hold that Trustee has stated a cause of action for the avoidance of actually fraudulent transfers under 11 U.S.C. § 548(a)(1)(A).

Counts Two & Three: Avoidance of Actually Fraudulent Transfers under 11 U.S.C. § 544, and Idaho Code Ann. §§ 55–906, 55–913(1)(a), 55–916, and 55–911

[9] Section 544(b) of the Bankruptcy Code permits the trustee to step into the shoes of an existing unsecured creditor who could have avoided an action under ***513** state law. 11 U.S.C. § 544(b)(1). Trustee here asserts claims against Movants under several Idaho Code sections.

Idaho Code § 55–913(1)(a) provides that a transfer is fraudulent if it is made with the "actual intent to hinder, delay, or defraud any creditor of the debtor." Idaho Code § 55–906 provides that "[e]very transfer of property ... [made] with intent to delay or defraud any creditor ... is void against all creditors of the debtor ... and against any person upon whom the estate of the debtor devolves in trust for the benefit of others than the debtor." For claims under both §§ 55–913(1)(a) and 55–906, the plaintiff must show actual intent to defraud with respect to the transfer at issue, and may do so using badges of fraud. *See Mohar v. McLelland Lumber Co.,* 95 Idaho 38, 501 P.2d 722, 726 (1972). Sections 55–916 and 55–917 provide for the avoidance and recovery, respectively, of such a fraudulent transfer by a creditor.

In determining actual intent to defraud, the court may consider whether:

(a) The transfer or obligation was to an insider;

(b) The debtor retained possession or control of the property transferred after the transfer;

(c) The transfer or obligation was disclosed or concealed;

(d) Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

(e) The transfer was of substantially all the debtor's assets;

(f) The debtor [absconded];

(g) The debtor removed or concealed assets;

(h) The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(i) The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(j) The transfer occurred shortly before or shortly after a substantial debt was incurred; and

(k) The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

Idaho Code Ann. § 55–913(2). This list, like the list in 11 U.S.C. § 548(a)(1)(A), is non-exclusive, and thus other factors may be taken into account. *Id.*

Movants raise the same argument against these state law actions as they raised for the avoidance claim under § 548(a)(1)(A), namely that Trustee has not alleged that the specific Transfers were themselves fraudulent transactions. I am unpersuaded. Courts in the Ninth Circuit have recognized the Ponzi presumption and applied it to state uniform fraudulent transfer laws like Idaho's. *See, e.g., Johnson v. Neilson (In re Slatkin)*, 525 F.3d 805, 814 (9th Cir.2008). Therefore, for the same reasons as stated above in my analysis of the § 548(a)(1)(A) count, I find that Trustee has sufficiently pled a claim for the avoidance of actually fraudulent transfers.

Count Four: Unjust Enrichment

[10][11] As an alternative grounds for relief, Trustee seeks to avoid the Transfers under the equitable doctrine of unjust enrichment. To succeed on an unjust enrichment claim, a plaintiff must show: "(1) a benefit conferred upon the defendant by the plaintiff; (2) appreciation by the defendant of such benefit; and (3) acceptance of the benefit under circumstances that would be inequitable for the defendant to retain the benefit without payment to the plaintiff of the value thereof." ***514***Indep. Sch. Dist. of Boise City v. Harris Family Ltd. P'ship*, 150 Idaho 583, 249 P.3d 382, 388 (2011) (citations and internal quotation marks omitted). "Inequity exists if a transaction is inherently unfair." *Id.*

[12] Movants argue that Trustee cannot maintain a cause of action for unjust enrichment here because "it is well settled law that where a transaction is governed by a valid contract, claims of unjust enrichment will not lie." (Doc. # 127, at 11.) Movants allege that the Transfers were paid pursuant to contracts between Movants and Debtors, and so Trustee's unjust enrichment claim must be dismissed. (*Id.*) Trustee responds that the Court has not yet found the contracts to be enforceable, and thus he is not precluded from asserting the unjust enrichment claim as an alternative theory.

[13] Trustee is correct, in that Idaho courts have held that "only when the express agreement is found to be enforceable is a court precluded from applying the equitable doctrine of unjust enrichment in contravention of the express contract." *Blaser v. Cameron*, 121 Idaho 1012, 829 P.2d 1361, 1366 (Ct.App.1991) (citations omitted). *Accord Thomas v. Thomas*, 150 Idaho 636, 249 P.3d 829, 836 (2011); *Wolford v. Tankersley*, 107 Idaho 1062, 695 P.2d 1201, 1203 (1984). Where it has not been determined that the contracts between Movants and Debtors are valid and enforceable, Trustee can plead a claim for unjust enrichment.

[14] Having established that Trustee can maintain an action for unjust enrichment, I must now turn to the question of whether Trustee has alleged sufficient facts to support such a claim. The Complaint must include some factual allegations which, if true, show that it would be inequitable for Movants to retain the Transfers. In the Complaint, Trustee states:

74. Plaintiffs reassert all of the allegations in the foregoing paragraphs of this Complaint as if more fully set forth herein.

75. Defendants and/or defendants John Doe 1–500 were enriched as a result of receiving the Two Year Transfers and the Four Year Transfers described in this Complaint by receiving something of value that belonged to Plaintiff.

76. These enrichments violate equity and good conscience.

> 77. These enrichments did not result from enforceable agreements between Plaintiff and Defendants.
>
> 78. By reason of the forgoing [sic], Defendants and/or defendants John Doe 1–500 should be compelled by this Court to make restitution to Plaintiff in the amount of the Two Year Transfers and the Four Year Transfers.

(Compl. ¶¶ 74–78.) As noted by Movants, Trustee makes no factual allegations supporting the legal conclusion that "these enrichments did not result from enforceable agreements between" Movants and Debtors; that is, Trustee has pled no facts showing why the contracts would be unenforceable. However, given that unjust enrichment is a broad remedy, it is an open question whether the Transfers could be found to "violate equity and good conscience" because they were part of Debtors' Ponzi scheme—none of the parties addressed this question in their briefing. As a result, I will allow Trustee to maintain this count in anticipation of further argument and development of the factual record.

Count Five: Avoidance and Recovery of Preferential Transfers under 11 U.S.C. § 547, 550, and 551

[15] Section 547 of the Bankruptcy Code enables the trustee to avoid certain transfers made by the debtor to or for the ***515** benefit of a creditor within ninety days before the petition for relief was filed. 11 U.S.C. § 547(b).

Movants argue that Trustee is barred from avoiding the Transfers by 11 U.S.C. § 546(e), which states:

> the trustee may not avoid a transfer that is ... a settlement payment as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a ... stockbroker ..., or that is a transfer made by or to (or for the benefit of) a ... stockbroker ... in connection with a securities contract, as defined in section 741(7).

Movants assert that they are "stockbrokers" as defined by the statute, and that the Transfers are either "settlement payments" or transfers made in connection with a "securities contract." Trustee responds that it is inappropriate to consider this affirmative defense at the motion to dismiss stage because it is unclear whether the transactions at issue here fall within the statute's parameters.

Courts in this district have considered the 546(e) defense at the motion to dismiss stage where the defense is clearly established on the face of the complaint. *See, e.g.* *Brandt v. B.A. Capital Co. LP (In re Plassein Int'l Corp.)*, 366 B.R. 318, 323–25 (Bankr.D.Del.2007). Nonetheless, I agree with Trustee that in this case, it is premature to dismiss this count on the basis of the 546(e) defense. The application of the defense is a fact-based inquiry. The only portion of the Complaint explaining Movants' role in the TIC sales reads as follows:

> [DBSI Securities], a registered broker-dealer and affiliate of DBSI, marketed and sold the TIC investments on a wholesale basis to various broker-dealers around the United States. The broker-dealers would, in turn, sell the TIC interests to the investing public and receive a commission on those sales.

(Compl. ¶ 16.) It is not clear from this description alone whether Movants are "stockbrokers" as contemplated by the statute, let alone whether the Transfers are "settlement payments." A "stockbroker" is a person who has a customer [FN6], as defined by 11 U.S.C. § 741(2), and who "is engaged in the business of effecting transactions in securities (i) for the account of others; or (ii) with members of the general public, from or for such person's own account." 11 U.S.C. § 101(53A). *See also* 5 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 546.06[2][e] (16th ed.) (noting that "[a] person who effects some securities transactions (including the pertinent transaction in a 546(e) dispute) but who is not, in a general sense, 'engaged in the business' of effecting such transactions is not a 'stockbroker' under the statute"). Movants must demonstrate that they fit within both prongs of this definition, and the Complaint does not ***516** clearly establish that they do. Further, without any factual details on the TIC sales agreements, I cannot say that the Transfers were made in connection with "securities contracts." Therefore, I will not consider the 546(e) defense at this point.

FN6. "customer" includes—

(A) entity with whom a person deals as

> principal or agent and that has a claim against such person on account of a security received, acquired, or held by such person in the ordinary course of such person's business as a stockbroker, from or for the securities account or accounts of such entity—
>
> (i) for safekeeping;
>
> (ii) with a view to sale;
>
> (iii) to cover a consummated sale;
>
> (iv) pursuant to a purchase;
>
> (v) as collateral under a security agreement; or
>
> (vi) for the purpose of effecting registration of transfer; and
>
> (B) entity that has a claim against a person arising out of—
>
> (i) a sale or conversion of a security received, acquired, or held as specified in subparagraph (A) of this paragraph; or
>
> (ii) a deposit of cash, a security, or other property with such person for the purpose of purchasing or selling a security
>
> 11 U.S.C. § 741(2).

Count Six: Avoidance and Recovery of Post–Petition Transfers under 11 U.S.C. §§ 549, 550, and 551

[16] Section 549 permits the trustee to avoid certain unauthorized post-petition transfers. 11 U.S.C. § 549(a). A key element to this cause of action is that the transfers at issue must have occurred "after the commencement of the case." *Id.*

Movants argue that Trustee has not identified any Transfers made after the petition date of November 10, 2008. In reviewing the list of Transfers on Exhibit B to the Complaint, I agree with Movants. Moreover, Trustee pleads the cause of action as follows:

> 93. Plaintiff pleads this Sixth Cause of Action in the alternative and repeats and realleges all of the allegations in the foregoing paragraphs of this Complaint as if more fully set forth herein.
>
> 94. Plaintiff brings this cause of action in the event that Plaintiff learns through discovery or otherwise that Defendants received one or more unauthorized post-petition transfers of an interest of the Debtors in property that is avoidable pursuant to section 549 of the Bankruptcy Code ("Post–Petition Transfers").
>
> 95. Each of the Post–Petition Transfers, if any, occurred after the applicable Debtors' Petition Date.
>
> 96. Each of the Post–Petition Transfers, if any, was authorized only under sections 303(f) or 542(c) of the Bankruptcy Code; or were not authorized under the Bankruptcy Code or the Court.
>
> 97. Each of Defendants and defendants John Doe 1–500 are either the initial transferee of the Post–Petition Transfers, if any, or the immediate or mediate transferee of such initial transferee or are the persons for whose benefit the Post–Petition Transfers were made.
>
> 98. As of the date hereof, Defendants and defendants John Doe 1–500 have not returned any of the Post–Petition Transfers, if any were made, to the Debtors' estates.
>
> 99. As a result of the foregoing, pursuant to sections 549(a), 550 and 551 of the Bankruptcy Code, Plaintiff is entitled to a judgment: (i) avoiding and preserving the Post–Petition Transfers, if any; (ii) directing that the Post–Petition Transfers, if any, be set aside; and (iii) recovering the Post–Petition Transfers, if any, or the value thereof, from the Defendants for the benefit of the Debtors' estates.

(Compl. ¶¶ 93–99.) With this pleading, Trustee concedes that he has not discovered any post-petition transfers made by Debtors to Movants. Even under the pre- *Twombly* relaxed pleading standard applied to trustees in bankruptcy, the trustee in an avoidance action must—at a minimum—plead the existence of a transfer. *See, e.g. OHC Liquidation Trust v. Credit*

Suisse First Boston (In re Oakwood Homes Corp.), 340 B.R. 510, 521–22 (Bankr.D.Del.2006). Because Trustee has not alleged that any such post-petition transfers exist, this claim must be dismissed.

Count Seven: Disallowance of Claims Pursuant to 11 U.S.C. § 502

[17] Under § 502(d) of the Bankruptcy Code

> the court shall disallow any claim of any entity ... from which property is recoverable under section ... 550 ... or that ***517** is a transferee of a transfer avoidable under section ... 544, 547, 548, 549, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable.
>
> 11 U.S.C. § 502(d).

Here, Trustee has not even alleged that Movants filed any proofs of claim. Further, this Court has previously held that a claim under § 502(d) is premature where the trustee does not yet have a judgment against the transferee. *See DHP Holdings II Corp. v. Peter Skop Indus. Inc. (In re DHP Holdings II Corp.)*, 435 B.R. 220, 226 (Bankr.D.Del.2010). Here, Trustee has not obtained a judgment on his avoidance claims. Thus, this count will be dismissed.

Conclusion

For the reasons detailed above, I will grant the Motion in part and deny it in part. Counts Six and Seven will be dismissed and all other counts will remain.

ORDER

For the reasons set forth in the Court's memorandum opinion of this date, the joint motion of certain broker-dealer defendants to dismiss all counts of the complaint (Doc. # 123) is granted in part and denied in part. Counts Six and Seven of the Complaint are **dismissed** and all other counts shall **remain.**

Bkrtcy.D.Del.,2012.
In re DBSI, Inc.
477 B.R. 504

END OF DOCUMENT

EXHIBIT 8

682 F.Supp.2d 417
(Cite as: 682 F.Supp.2d 417)

H

United States District Court,
S.D. New York.
UNITED STATES of America,
v.
Marc DREIER, Defendant.

No. 09 Cr. 085 (JSR).
Feb. 5, 2010.

Background: In a securities fraud prosecution, coordination agreement was reached between the government and the trustee for the defendant's corporation's Chapter 11 bankruptcy estate, stipulation was reached between government and trustee for defendant's Chapter 7 bankruptcy estate, and stipulation was reached between certain investors and the government.

Holdings: The District Court, Jed S. Rakoff, J., held that:
(1) Chapter 11 trustee's promise was valid consideration to support coordination agreement and stipulation between government and Chapter 11 trustee;
(2) stipulation between government and Chapter 7 trustee would be approved; and
(3) pro rata distribution scheme for restitution funds was warranted.

So ordered.

West Headnotes

[1] Bankruptcy 51 ⚿3032.1

51 Bankruptcy
51IX Administration
51IX(A) In General
51k3032 Compromises, Releases, and Stipulations
51k3032.1 k. In general. Most Cited Cases

Promise by trustee for securities fraud defendant's brokerage's Chapter 11 bankruptcy estate, not to challenge either the forfeiture of certain properties or certain payments to investors was not illusory, and thus, promise was valid consideration to support coordination agreement and stipulation between government and Chapter 11 trustee, pursuant to which the government also agreed not to seek forfeiture of recoveries generated through avoidance actions by trustee and to release to trustee certain seized artworks, where the trustee's claims were not so frivolous that their resolution would not result in protracted and costly litigation that could delay or diminish victims' recoveries. Comprehensive Crime Control Act of 1984, § 303(a), 21 U.S.C.A. § 853(a).

[2] Criminal Law 110 ⚿1220

110 Criminal Law
110XXVI Incidents of Conviction
110k1220 k. Civil liabilities to persons injured; reparation. Most Cited Cases

Although the government is obligated to confer with crime victims before compromising claims against defendants, nothing in the Crime Victims' Rights Act requires the government to seek approval from crime victims before negotiating or entering into a settlement agreement. 18 U.S.C.A. § 3771(a)(4, 5).

[3] Bankruptcy 51 ⚿3033

51 Bankruptcy
51IX Administration
51IX(A) In General
51k3032 Compromises, Releases, and Stipulations
51k3033 k. Judicial authority or approval. Most Cited Cases

Stipulation between government and trustee for securities fraud defendant's Chapter 7 bankruptcy estate, pursuant to which government proposed to release 10 percent of the proceeds from the sale of real properties subject to forfeiture to the estate, would be approved; the agreement provided fair compensation for the Chapter 7 trustee's sale of these properties and his entitlement to the personalty there-

in. Comprehensive Crime Control Act of 1984, § 303(a), 21 U.S.C.A. § 853(a).

[4] Sentencing and Punishment 350H ⚿2210

350H Sentencing and Punishment
350HXI Restitution
350HXI(G) Payment
350Hk2210 k. Disposition of proceeds. Most Cited Cases

Pro rata distribution scheme, providing for pro rata distribution of restitution funds to all corporate and individual victims of defendant's securities fraud crimes, was warranted in restitution order against securities fraud defendant, where the fraud scheme involved multiple victims and commingling of victims' assets.

***417** Jonathan R. Streeter, Anna Elizabeth Arreola, Jeffrey Ehrlich Alberts, ***418**Sharon Cohen Levin, U.S. Attorney's Office, New York, NY, for United States of America.

MEMORANDUM ORDER

JED S. RAKOFF, District Judge.

An under-appreciated evil of substantial frauds like those of Marc Dreier is how they pit their victims against one another. Where, as here, the funds remaining after the fraud is uncovered are insufficient to make whole Dreier's numerous victims and creditors, these unfortunates are left to squabble over who should get what. In this case, moreover, resolution of these competing claims involves consideration of three bodies of law—criminal law, securities law, and bankruptcy law—that cannot always be reconciled without some friction.

For some time now, it has been evident to this Court in presiding over the criminal action against Dreier, and to the judges presiding over the civil enforcement action brought against Dreier by the Securities and Exchange Commission and the bankruptcy proceedings involving the estates of Dreier and his law firm, Dreier LLP, that these inherent tensions are best addressed through coordination and cooperation by all concerned. Accordingly, on April 22, 2009, the three judges convened a joint hearing to urge such a resolution by the affected parties. Eventually, the Government, the Commission (which is no longer directly affected), the bankruptcy trustees, and various other affected parties reached a global settlement in the form of several proposed agreements and orders, to which others filed objections. On January 12, 2010, Senior District Judge Cedarbaum, Chief Bankruptcy Judge Bernstein, and the undersigned held a joint hearing on the proposed settlement, to which all affected parties were invited to attend and following which the judges received further written submissions. Now, subject only to certain related proposals pending before the Bankruptcy Court, this Court, confirming its Memorandum issued on January 29, 2010, hereby approves the proposed settlement agreements and reconfirms the Court's prior restitution order as well.

The first of the proposed settlement agreements is a "Coordination Agreement" between the Government and the Trustee for the Dreier LLP bankruptcy estate (the "Chapter 11 Trustee"). Under this agreement, the Government will not seek forfeiture of any recoveries generated through avoidance actions brought by the Chapter 11 Trustee, and the Government will release to the Chapter 11 Trustee ninety-seven seized artworks that the Government is presently unable to trace to the proceeds of Dreier's offenses. In return, the Chapter 11 Trustee promises not to contest forfeiture of the properties listed in the schedule to the Court's Preliminary Order of Forfeiture entered July 13, 2009.

Additionally, under the Coordination Agreement, the Chapter 11 Trustee will not challenge the forfeiture of funds disgorged by GSO Capital Partners and its affiliates ("GSO") pursuant to a proposed consent order (the "GSO Consent Order"). Under the GSO Consent Order, GSO will forfeit to the Government $30,895,027.78—an amount representing payments of interest and fees received by GSO facilities in connection with their investments in Dreier's fictitious promissory notes. In exchange for this payment, the Government will forego seeking forfeiture of other GSO facility funds presently under restraint because of their connection to Dreier's note fraud.

In conjunction with the Coordination Agreement and the GSO Consent Order, certain related applications are also pending before the Bankruptcy Court. First, the Chapter 11 Trustee seeks Bankruptcy ***419** Court approval of the Coordination Agreement. Second, the Chapter 11 Trustee and the Trustee for Dreier's personal bankruptcy (the "Chapter 7 Trustee")

seek Bankruptcy Court approval of agreements with GSO whereby GSO will pay $9,250,000 to the Chapter 11 Trustee and $250,000 to the Chapter 7 Trustee in exchange for the Trustees' promise not to litigate any claims against GSO and the entry of a Bar Order enjoining creditors and other parties in interest from seeking to recover funds from GSO. Although these applications are before the Bankruptcy Court, not this Court, the Coordination Agreement provides that, even if it is approved by this Court, it will not take effect unless the Bankruptcy Court approves the settlement between GSO and the Chapter 11 Trustee.

Also before this Court are stipulations between the Government and the Chapter 7 Trustee (the "Chapter 7 Trustee Stipulations") regarding the sale of three real properties listed in the Preliminary Order of Forfeiture (two houses in East Quogue and a Manhattan condominium). In exchange for the Chapter 7 Trustee's successful efforts to market and sell these properties, and because the Government previously agreed to release the personalty in these properties to the Chapter 7 Trustee, the Government proposes to release ten percent of the proceeds from the sale of these properties to the Chapter 7 bankruptcy estate.

Finally, before the Court is a proposed stipulation (the "Fortress Stipulation") between the Government and certain facilities managed by Fortress Investment Group LLC and its affiliates ("Fortress"). Because the Fortress facilities lost over $84 million from their investments in Dreier's fictitious notes, the Government does not intend to seek forfeiture of certain note fraud proceeds that were received by these facilities; accordingly, the proposed stipulation would vacate the restraining order that is currently freezing those funds.

While the undersigned has solicited the opinions of Judge Cedarbaum and Chief Bankruptcy Judge Bernstein as to their views of these proposals from the standpoint of securities law and bankruptcy law, this Court must address these proposals, first and foremost, from the standpoint of federal criminal law, especially the provisions of federal criminal law dealing with forfeiture and restitution. Under the restitution provisions, victims of crimes have the right to "full and timely restitution as provided in law." 18 U.S.C. § 3771(a)(6). This Court "shall ensure" that these and other victims' rights are vindicated, and the Government has the obligation to "make [its] best efforts" to this end. *Id.* § 3771(b)(1), (c)(1). Thus, while the related forfeiture provisions provide only that a defendant shall forfeit "to the United States" the fruits of his crime, 21 U.S.C. § 853(a), including so-called "substitute assets" under certain conditions, *id.* § 853(p), the Government has represented that, consistent with applicable laws and regulations, the assets obtained from the forfeitures in this case will be applied toward victim restitution, *see* Gov't Letter, 4/22/09, at 10.

In furtherance of these laws, the Court, in the aforementioned Preliminary Order of Forfeiture, ordered preliminary forfeiture to the United States of $746,690,000 in cash held in accounts controlled by Dreier, as well as preliminary forfeiture of specific properties listed in that order. As part of Dreier's sentence, he was also ordered to make an additional restitution payment to his victims in the amount of $387,675,303. Also, on September 29, 2009, the Court entered a Second Amended Restitution Order specifying that if restitution is made in partial payments, those ***420** payments are to distributed to the victims on a *pro rata* basis according to their loss amounts.

[1] The forfeiture laws further authorize the Government to compromise competing claims to forfeited assets. 21 U.S.C. § 853(i)(2); *accord In re W.R. Huff Asset Mgmt. Co.*, 409 F.3d 555, 564 (2d Cir.2005). Many of the objections to the settlement agreements here under consideration come down to the assertion that the Government should not compromise its claims to certain artwork and other property that, in the objectors' view, belong indirectly to the victims. Thus, Fortress and certain other hedge funds (collectively, the "Hedge Funds"), who are by some measures the largest victims of Dreier's frauds (but who were also arguably the recipients of fraud proceeds) assert that the property to be turned over to the Chapter 11 Trustee under the Coordination Agreement is indisputably forfeitable, so its transfer would diminish the pool of assets available for distribution to the victims. In response to the Government's argument that the artwork proposed to be turned over to the Chapter 11 Trustee cannot be traced to the proceeds of Dreier's frauds, the Hedge Funds claim that such property is nevertheless subject to forfeiture as substitute assets. Furthermore, according to these victims, the "consideration" flowing to the Government under the Coordination Agree-

ment—the Chapter 11 Trustee's promise not to challenge either the forfeiture of the properties specified in the Preliminary Order of Forfeiture or the $30.9 million payment under the GSO Consent Order—is illusory, as there would be no merit to any such challenge.

Although not without some merit, the Hedge Funds' arguments are ultimately unpersuasive. While the Chapter 11 Trustee's claims to the forfeited assets might ultimately prove defective, they are not so frivolous that their resolution would not result in protracted, costly, internecine litigation that would, at a minimum, have the effect of delaying and diminishing the victims' recoveries. For example, it is unclear whether the Government's interest in substitute assets would relate back to the date of the wrongful acts. *See* United States v. Parrett, 530 F.3d 422, 430 (6th Cir.2008) (describing circuit split on this issue). Thus, to the extent that the Government's interest in such property depends on the application of this "relation back" doctrine, litigation would be far from frivolous and its outcome uncertain. Concomitantly, the Government's promise to refrain from seeking forfeiture of any avoidance recoveries does not appear to give up anything of value, as the Government has taken the position that it is not entitled to pursue such forfeiture actions, *see* Transcript, 1/12/10 Joint Hearing ("Tr.") 35, and the Hedge Funds have not identified any authority indicating the contrary. It follows that one effect of the agreement is to incentivize the Chapter 11 Trustee to go after recoveries the Government could not pursue. While any such recoveries will go to the creditors of the Chapter 11 estate, many of these are also victims of the fraud.

It may also be noted that the Hedge Funds do not object to either the GSO Consent Order or the Fortress Stipulation insofar as they involve the Government's stipulation that it will not seek additional forfeiture from these parties. This is, in effect, contrary to their argument that the Government should seek to maximize the amount of assets available for distribution to victims regardless of other equitable considerations. It is hence evident that the Hedge Funds' objections to the Coordination Agreement prove too much, as they are unwilling to carry such objections ***421** to their logical conclusions when doing so might adversely affect their own interests.

The other objections stated by the Hedge Funds are similarly unpersuasive. For example, at the joint hearing on January 12, 2010, counsel for Eton Park Capital Management, L.P., one of the Hedge Funds, complained that the proposed settlement was reached without adequate input from some or all of the Hedge Funds. *See* Tr. 45–46. When pressed, however, counsel was unable to make a specific application to the Court apart from requesting that approval of the Coordination Agreement be delayed until more "information" was provided regarding how the victims would be treated. *Id.* at 46. Similar process-based objections were advanced by Fortress at the joint hearing and by the Hedge Funds in written submissions.

[2] Although the Government is obligated to confer with the victims before compromising claims, *see* 18 U.S.C. § 3771(a)(4)-(5), "[n]othing in the [Crime Victims' Rights Act] requires the Government to seek approval from crime victims before negotiating or entering into a settlement agreement." *W.R. Huff Asset Mgmt. Co.*, 409 F.3d at 564. The Court accepts the Government's representation, not directly disputed by the Hedge Funds, that opportunities to confer were early offered to the Hedge Funds, who failed to take advantage of the offer, Tr. 47. Moreover, as a result of the joint hearings in this matter, the Hedge Funds were aware at least as early as April 22, 2009 that settlement negotiations between the Government and the trustees were actively ongoing, and they could have sought to be heard by the Government at any time in the process.

The Court is driven to the conclusion that the real reason for the Hedge Funds' objections to the settlement is their recognition that, even though they were victims of Dreier's frauds, they were also the seeming recipients of fraud proceeds, and hence the bankruptcy creditors (including other victims) may have claims against the Hedge Funds in the form of so-called avoidance actions that, as a result of the proposed settlement, the Chapter 11 Trustee will be free to pursue without any fear that any recoveries will revert to the United States. This is hardly a reason for rejecting the settlement. Whatever the merits of the hypothesized avoidance actions, they will only serve to more perfectly resolve the relative rights of victims and creditors in accordance with the laws of the United States.

[3] Thus, despite the foregoing objections, the

Court finds that the Coordination Agreement is reasonable and in the best interests of the victims collectively. As there appears to be no objection before this Court to the GSO Consent Order, which will make $30.9 million available for victim restitution, the Court approves that agreement as well.[FN1] As to the Chapter 7 Trustee stipulations, although the Hedge Funds object to the payment of ten percent of real property proceeds to the Chapter 7 Trustee, this objection strikes the Court as yet another manifestation of their concern about funding the bankruptcy trustees' litigation efforts, which the Court finds unpersuasive for the reasons noted above. Because this amount is fair compensation for the Chapter 7 Trustee's sale of these properties and his entitlement to the personalty therein, the Court approves these stipulations. Finally, as ***422** there is no objection to the Fortress Stipulation, and because the Government's policy of eschewing forfeiture from "net losers" makes sense, the Court approves that stipulation as well.

> FN1. Insofar as there are objections to the Bar Order's preclusion of victim or creditor actions against GSO, *see* Tr. 11, such objections are to be addressed by the Bankruptcy Court in the first instance.

The final matter to be resolved is the motion of an individual victim, Paul Gardi, to modify the Second Amended Restitution Order's scheme of *pro rata* distribution in order to provide Gardi with special priority. Gardi alleges that Dreier, who was Gardi's lawyer, forged Gardi's signature to a settlement agreement between JANA (a hedge fund) and a company controlled by Gardi, and then arranged for JANA to wire the settlement funds, in the amount of $6.3 million, into a trust account controlled by Dreier, who then used the funds for himself. Gardi claims that he is entitled to priority over other victims because he is an individual as opposed to an institutional investor, because the theft of his settlement funds is different in nature from the note fraud losses experienced by the Hedge Funds, and because the relative economic impact of Gardi's losses is more substantial than the impact on institutional victims.

Several affected parties have responded by arguing, among other things, that Gardi's motion to amend the Second Amended Restitution Order is untimely or otherwise procedurally improper; that Gardi was not the only individual victim harmed by Dreier's misappropriation or other misuse of escrowed funds; that Gardi's loss should not be considered to have been suffered by an individual, since the settlement was with his company; that Gardi's financial sophistication is not unlike that of an institutional investor; that JANA, rather than Gardi, was the true victim of this particular fraud; and that there is no principled basis for treating Gardi's loss as different in kind from the losses experienced by Dreier's other victims. The Government has taken the position that a *pro rata* share is appropriate because "no victim is any more or less deserving here of the restitution." Tr. 16. Finally, in an intermediate position, the representative of the bankruptcy estates of 360networks (USA) Inc. and its affiliates (the "360networks Representative") has submitted a response identifying the 360networks estates as similarly situated to Gardi in that they were victims of theft by Dreier in his capacity as their lawyer, and urges the Court to distinguish between "client" victims and "note fraud" victims by providing client victims with priority.

[4] The Court will assume *arguendo* that the procedural objection to Gardi's submissions would ultimately not prevail and will instead proceed to the underlying merits. There is nothing *per se* unfair about a *pro rata* distribution; the Second Circuit has endorsed this approach as particularly appropriate for frauds like Dreier's involving a Ponzi scheme or the commingling of similarly situated victims' assets. *See SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 88–89 (2d Cir.2002). It is clear from the responses that Gardi is not the only "client" victim of Dreier's frauds or to whom Dreier owed fiduciary duties, and each case doubtless has its own nuances. Additionally, the "note fraud" victims are only immediately the Hedge Funds; it is the investors in these funds, including individuals, charitable and educational institutions, and many others who are the ultimate "note fraud" victims. The truth is that a fraud as large and egregious as Dreier's is like an earthquake that savages its victims at random and is followed by a series of aftershocks that destroys still further assets. Any alternative to the *pro rata* approach would entail a costly and extensive inquiry into the circumstances of each victim's loss, which would likely devolve into a war of ***423** recriminations, to the detriment of all concerned. Accordingly, the Court denies Gardi's motion and confirms the *pro rata* distribution scheme set forth in the Second Amended Restitution Order.

For the foregoing reasons, the Court hereby reaffirms its Memorandum of January 29, 2010 and approves the Coordination Agreement, the GSO Consent Order, the Chapter 7 Trustee Stipulations, and the Fortress Stipulation. The Clerk of the Court is directed to close the entries numbered 102 and 106 on the docket of this case.[FN2]

> FN2. Still pending before the Court are three petitions filed pursuant to 21 U.S.C. § 853(n) for ancillary hearings to determine third party interests in property subject to forfeiture. Motion practice is underway with respect to the Government's motion to dismiss the petition filed by the 360networks Representative. Also, the Hedge Funds, in a series of letters submitted to the relevant Courts and the Government, set forth several arguments why the petition filed by Heathfield Capital Limited ("Heathfield") should be dismissed. While these arguments will be considered if and when the Court reaches the merits of the Heathfield petition, they provide no reason to defer approval of the settlement agreements discussed herein.

SO ORDERED.

S.D.N.Y.,2010.
U.S. v. Dreier
682 F.Supp.2d 417

END OF DOCUMENT

EXHIBIT 9

454 B.R. 317, 55 Bankr.Ct.Dec. 81
(Cite as: 454 B.R. 317)

H

United States Bankruptcy Court,
S.D. New York.
In re BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Debtor.
Irving H. Picard, as Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff,
v.
Cohmad Securities Corporation, et al., Defendants.

Bankruptcy No. 08–01789 (BRL).
Adversary No. 09–1305 (BRL).
Aug. 1, 2011.

Background: Trustee in substantively consolidated liquidation, under Securities Investor Protection Act (SIPA), of investment company through which Ponzi scheme was operated and its principal brought action against registered broker-dealer that had been formed for the purpose of recruiting investors to company, broker-dealer's co-founder, broker-dealer's registered representatives, and others, seeking to avoid and recover commissions and fees paid by company to broker-dealer and its representatives, as well as fictitious profits that certain defendants withdrew from their accounts. Defendants moved to dismiss.

Holdings: The Bankruptcy Court, Burton R. Lifland, J., held that:
(1) trustee sufficiently pled actual fraud pursuant to the Bankruptcy Code and the New York Debtor and Creditor Law (NYDCL);
(2) transferee's fraudulent intent did not have to be established to state a claim for actual fraudulent transfer under the NYDCL;
(3) trustee sufficiently pled constructive fraud under the Code and the NYDCL;
(4) trustee sufficiently pled claims to recover actual fraudulent transfers made more than six years before the filing date of the SIPA liquidation proceeding pursuant to New York's "discovery rule"; and
(5) trustee sufficiently pled claims to recover subsequent transfers of commissions from broker-dealer's representatives.

Motions to dismiss denied.

See also 440 B.R. 243, 424 B.R. 122.

West Headnotes

[1] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in substantively consolidated liquidation, under Securities Investor Protection Act (SIPA), of investment company through which Ponzi scheme was operated and its principal, who sought to avoid withdrawals of fictitious profits and initial transfers of commissions, sufficiently pled actual fraud pursuant to the Bankruptcy Code and the New York Debtor and Creditor Law (NYDCL); trustee identified transfers with particularity, identifying each account by name and number, specifying, with respect to each withdrawal of fictitious profits, the date, account number, transferee, transferor, method of transfer, and amount transferred, and identifying the initial transfers of commissions, and, given the breadth and notoriety of principal's Ponzi scheme, and his criminal admission, trustee adequately alleged fraudulent intent by virtue of the "Ponzi scheme presumption." 11 U.S.C.A. § 548(a)(1)(A); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[2] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Actual fraudulent transfer claims brought under

either the Bankruptcy Code or the New York Debtor and Creditor Law (NYDCL) must meet Rule 9(b)'s heightened pleading requirements. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[3] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

To meet the heightened pleading requirements of Rule 9(b), trustee bringing an actual fraudulent transfer claim under either the Bankruptcy Code or New York Debtor and Creditor Law (NYDCL) must (1) state with particularity the circumstances constituting fraud or mistake, but may plead (2) the malice, intent, knowledge, and other conditions of a person's mind generally. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[4] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Under either the Bankruptcy Code or the New York Debtor and Creditor Law (NYDCL), to state an actual fraudulent transfer claim with Rule 9(b) particularity, a party must ordinarily allege the following: (1) the property that was conveyed, (2) the timing and, if applicable, frequency of the transfer, and (3) the consideration paid for the transfer. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[5] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

When an actual fraudulent transfer claim under either the Bankruptcy Code or New York Debtor and Creditor Law (NYDCL) is asserted by a bankruptcy trustee, courts are to adopt a more liberal view of whether the claim has been stated with the requisite Rule 9(b) particularity than if the plaintiff is not a trustee, since a trustee is an outsider to the transaction who must plead fraud from second-hand knowledge. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[6] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

When an actual fraudulent transfer claim under either the Bankruptcy Code or New York Debtor and Creditor Law (NYDCL) is asserted by a bankruptcy trustee whose lack of personal knowledge is compounded with complicated issues and transactions that extend over lengthy periods of time, the trustee's handicap increases, and even greater latitude should be afforded in determining whether the trustee has stated a claim with the requisite Rule 9(b) particularity. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[7] Fraudulent Conveyances 186 ⚿263(2)

186 Fraudulent Conveyances
186III Remedies of Creditors and Purchasers
186III(H) Pleading
186k258 Bill, Complaint, or Petition
186k263 Fraudulent Transaction
186k263(2) k. Intent of grantor. Most Cited Cases

Fraudulent Conveyances 186 ⚿263(4)

186 Fraudulent Conveyances
186III Remedies of Creditors and Purchasers
186III(H) Pleading
186k258 Bill, Complaint, or Petition
186k263 Fraudulent Transaction
186k263(4) k. Knowledge and intent of grantee. Most Cited Cases

To state a claim for actual fraudulent transfer under the New York Debtor and Creditor Law (NYDCL), it is the transferor's intent alone, and not the intent of the transferee, that is relevant. N.Y.McKinney's Debtor and Creditor Law § 276.

[8] Fraudulent Conveyances 186 ⚿155

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(L) Knowledge and Intent of Grantee
186k155 k. Elements of fraud in general. Most Cited Cases

Fraudulent Conveyances 186 ⚿165

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(L) Knowledge and Intent of Grantee
186k164 Effect of Good Faith of Grantee
186k165 k. In general. Most Cited Cases

Section of the New York Debtor and Creditor Law (NYDCL) providing an affirmative defense to a bona fide purchaser for value without knowledge of the fraud to retain the transfer requires that the transferee's intent be considered at the summary judgment phase or at trial on a full evidentiary record. N.Y.McKinney's Debtor and Creditor Law §§ 276, 278.

[9] Bankruptcy 51 ⚿2726.1(3)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726.1 Burden of Proof
51k2726.1(3) k. Fraudulent transfers. Most Cited Cases

Under the New York Debtor and Creditor Law (NYDCL), if a bankruptcy trustee meets the evidentiary burden of proving a prima facie case of actual fraud, the burden shifts to the transferee to establish the affirmative "good faith" defense. N.Y.McKinney's Debtor and Creditor Law §§ 276, 278.

[10] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in substantively consolidated liquidation, under Securities Investor Protection Act (SIPA), of investment company through which Ponzi scheme was operated and its principal, who sought to avoid withdrawals of fictitious profits and initial transfers of commissions, sufficiently pled constructive fraud pursuant to the Bankruptcy Code and the New York Debtor and Creditor Law (NYDCL); trustee alleged that withdrawals from investment advisory accounts consisted solely of fictitious profits and were therefore not received in exchange for reasonably equivalent value, and that neither broker-dealer that had been formed for the purpose of recruiting investors to company nor its co-founder conferred sufficient value in exchange for company's initial transfers of commissions, as neither co-founder nor broker-dealer, through its officers and directors, was alleged to lack knowledge of the fraudulent scheme. 11 U.S.C.A. § 548(a)(1)(B); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; Fed.Rules Bankr.Proc.Rule 7008(a), 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law §§ 273–275.

[11] Bankruptcy 51 ⚿2162

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General

51k2162 k. Pleading; dismissal. Most Cited Cases

Purpose of pleading requirement mandating that plaintiff provide a short and plain statement of the claim showing that he is entitled to relief is to ensure that the defendant receives fair notice of what the claim is and the grounds upon which it rests. Fed.Rules Bankr.Proc.Rule 7008(a), 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.

[12] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

In determining whether a plaintiff has sufficiently pled a constructive fraudulent transfer under the Bankruptcy Code and the New York Debtor and Creditor Law (NYDCL), the sole consideration should be whether, consistent with the requirements of the rule requiring that a complaint contain a short and plain statement of the claim, the complaint gives the defendant sufficient notice to prepare an answer, frame discovery, and defend against the charges. 11 U.S.C.A. § 548(a)(1)(B); Fed.Rules Bankr.Proc.Rule 7008(a), 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law §§ 273–275.

[13] Bankruptcy 51 ⚿2650(1)

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2650 Consideration
51k2650(1) k. In general. Most Cited Cases

Fraudulent Conveyances 186 ⚿24(1)

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(B) Nature and Form of Transfer
186k24 Transactions Subject to Attack by Creditors
186k24(1) k. In general. Most Cited Cases

Fraudulent Conveyances 186 ⚿77

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(G) Consideration
186k77 k. Sufficiency in general. Most Cited Cases

When investors invest in a Ponzi scheme, any payments that they receive in excess of their principal investments can be avoided by the bankruptcy trustee as constructively fraudulent transfers. 11 U.S.C.A. § 548(a)(1)(B); N.Y.McKinney's Debtor and Creditor Law §§ 273–275.

[14] Bankruptcy 51 ⚿2650(1)

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2650 Consideration
51k2650(1) k. In general. Most Cited Cases

Fraudulent Conveyances 186 ⚿77

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(G) Consideration
186k77 k. Sufficiency in general. Most Cited Cases

In determining, for purposes of a claim of constructive fraudulent transfer under the Bankruptcy Code or the New York Debtor and Creditor Law (NYDCL), whether transferees conferred sufficient value in exchange for certain transfers, the court must ultimately examine the totality of the circumstances, including the arms-length nature of the transaction and the good faith of the transferee. 11 U.S.C.A. § 548(a)(1)(B); N.Y.McKinney's Debtor and Creditor Law §§ 273–275.

[15] Securities Regulation 349B ⚿185.18

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers;

Securities Investor Protection Corporation
349Bk185.18 k. Requisites of claims; time for filing. Most Cited Cases

In determining timeliness of fraudulent conveyance claims brought by Securities Investor Protection Act (SIPA) trustee under the New York Debtor and Creditor Law (NYDCL), the relevant date was the filing date of the SIPA liquidation proceeding, not the filing date of trustee's avoidance complaint. 11 U.S.C.A. §§ 544(b), 546(a); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; N.Y.McKinney's CPLR 213(8).

[16] Securities Regulation 349B ⚿185.18

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.18 k. Requisites of claims; time for filing. Most Cited Cases

Trustee in substantively consolidated liquidation, under Securities Investor Protection Act (SIPA), of investment company through which Ponzi scheme was operated and its principal sufficiently pled claims to recover actual fraudulent transfers from defendants made more than six years before the filing date of the SIPA liquidation proceeding pursuant to New York's "discovery rule"; complaint sufficiently alleged the existence of a category of creditors who could have invoked the discovery rule, namely, company's defrauded customers, and that the claims were commenced within two years of the reasonable discovery of the fraud. 11 U.S.C.A. §§ 544, 550(a), 551; Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; N.Y.McKinney's CPLR 203(g), 213(8); N.Y.McKinney's Debtor and Creditor Law §§ 276, 278, 279.

[17] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in substantively consolidated liquidation, under Securities Investor Protection Act (SIPA), of investment company through which Ponzi scheme was operated and its principal sufficiently pled claims to recover, under the Bankruptcy Code and the New York Debtor and Creditor Law (NYDCL), subsequent transfers of commissions from representatives of registered broker-dealer that had been formed for the purpose of recruiting investors to company; because trustee sought to recover the commissions from the representatives as subsequent transferees, not initial transferees, he was not required to prove a prima facie case of avoidability against them, and the information contained in the complaint and the exhibits attached thereto provided more than enough detail to provide the representatives with notice of when, in what amount, with what frequency, and from whom they received subsequent transfers of commissions, as well as why. 11 U.S.C.A. § 550(a)(2); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; N.Y.McKinney's Debtor and Creditor Law § 278.

[18] Securities Regulation 349B ⚿185.16

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.16 k. Customers' claims; who are customers. Most Cited Cases

Allegations made by trustee in substantively consolidated liquidation, under Securities Investor Protection Act (SIPA), of investment company through which Ponzi scheme was operated and its principal, that company's books and records indicated that transfers to specified customers included fictitious profits above the amount of principal invested, precluded those customers from receiving Securities Investor Protection Corporation (SIPC) advances and distributions from the pool of assets collected by trustee. Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

[19] Bankruptcy 51 ⚿2164.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2164 Judgment or Order

51k2164.1 k. In general. Most Cited Cases

Local bankruptcy rule authorizing motions for reargument is strictly construed to avoid repetitive arguments on issues that the court has already fully considered. U.S.Bankr.Ct.Rules S.D.N.Y., Rule 9023–1(a).

[20] Bankruptcy 51 2164.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2164 Judgment or Order
51k2164.1 k. In general. Most Cited Cases

Motion for reargument is not a vehicle for relitigating old issues, presenting the case under new theories, securing a rehearing on the merits, or otherwise taking a second bite at the apple. U.S.Bankr.Ct.Rules S.D.N.Y., Rule 9023–1(a).

***321** Baker & Hostetler LLP, By: David J. Sheehan, John W. Moscow, Marc E. Hirschfield, Oren J. Warshavsky, New York, NY, for Plaintiff Irving H. Picard, Trustee for the Substantively Consolidated SIPA Liquidation of Bernard L. Madoff Investment Securities LLC and Bernard L. Madoff.

Vinson & Elkins LLP, By: Clifford Thau, Steven Paradise, Joseph F. Kroetsch, New York, NY, for Defendants Cohmad Securities Corporation, Maurice J. Cohn, Marcia B. Cohn, Milton S. Cohn, and Marilyn Cohn.

Butzel Long, P.C., By: Eric B. Fisher, New York, NY, Siegel, Lipman, Dunay Shepard & Miskel, LLP, By: Kenneth Lipman, Boca Raton, FL, for Defendants Richard Spring, The Spring Family Trust, and The JeanneT. Spring Trust.

Coppel, Laughlin, Blount & Lavin, LLP, By; Mark A. Blount, John J. Lavin, Chester,***322** NJ, for Defendants Alvin J. Delaire, Jr. and Carole Delaire.

Drohan Lee, LLP, By: Vivian R. Drohan, New York, NY, for Stanley Mervin Berman, Joyce Berman, and the S & J Partnership.

Rattet, Pasternak & Gordon Oliver LLP, By: James B. Glucksman, Harrison, NY, for Defendant Jane Delaire a/k/a Jane Delaire Hackett.

Hoffinger Stern & Ross, LLP, By: Jack S. Hoffinger, Fran Hoffinger, New York, NY, for Defendants Cyril Jalon, the Estate of Elena Jalon, The Joint Tenancy of Phyllis Guenzburger and Fabian Guenzburger, and The Joint Tenancy of Robert Pinchou and Fabian Guenzburger.

Edward H. Kohlschreiber, Edward H. Kohlschreiber Sr. Rev. Mgt. Trust, Pro Se.

MEMORANDUM DECISION AND ORDER DENYING DEFENDANTS' MOTIONS TO DISMISS TRUSTEE'S COMPLAINT

BURTON R. LIFLAND, Bankruptcy Judge.

Like Icarus, were the Cohmad Defendants singed by flying too close to the sun? [FN1]

FN1. Icarus, a Greek mythological figure, attempted to escape imprisonment on the island of Crete by means of wings constructed from feathers and wax. Despite his father's warnings, Icarus giddily flew higher toward the bright [Madoff] sun until it ultimately melted his wings of "innocence," sending him to his fate in the sea below. *See* http:// www. pantheon. org/ articles/ i/ icarus. html (last visited Aug. 1, 2011).

Before this Court are the motions (the "Motions to Dismiss") of (1) Cohmad Securities Corporation ("Cohmad"), Maurice "Sonny" J. Cohn ("Sonny Cohn"), Marcia B. Cohn ("Marcia Cohn"), Milton S. Cohn ("Milton Cohn") and Marilyn Cohn; (2) Richard Spring, The Spring Family Trust and The Jeanne T. Spring Trust; (3) Jane M. Delaire a/k/a Jane Delaire Hackett; (4) Stanley Mervin Berman ("Berman"), Joyce Berman and the S & J Partnership; (5) Alvin "Sonny" Delaire, Jr. ("Delaire") and Carole Delaire; (6) The Joint Tenancy of Phyllis Guenzburger and Fabian Guenzburger (the "Guenzburger Tenancy") and The Joint Tenancy of Robert Pinchou and Fabian Guenzburger (the "Pinchou Tenancy," and together with the Guenzburger Tenancy, the "Tenancy Defendants"); (7) Cyril Jalon ("Jalon") and the Estate of Elena Jalon; and (8) Edward H. Kohlschreiber and Edward

H. Kohlschreiber Sr. Rev. Mgt. Trust (collectively, the "Moving Defendants") [FN2] seeking to dismiss the amended complaint (the "Complaint") of Irving H. Picard, Esq. (the "Trustee" or "Plaintiff"), trustee for the substantively consolidated Securities Investor Protection Act [FN3] ("SIPA") liquidation of Bernard L. Madoff Investment Securities LLC ("BLMIS") and Bernard L. Madoff ("Madoff"), filed pursuant to SIPA sections ***323** 78fff(b) and 78fff–2(c)(3),[FN4] sections 105(a), 502(d), 542, 544, 547, 548(a), 550(a) and 551 of the Bankruptcy Code (the "Code"), various sections of New York Debtor and Creditor Law [FN5] (the "NYDCL") and other applicable law for turnover and accounting, preferences, fraudulent conveyances, damages, and objections to SIPA claims. [FN6] The Motions to Dismiss assert that the Complaint fails to state a claim upon which relief can be granted pursuant to Federal Rule of Civil Procedure ("Rule") 12(b)(6), made applicable herein by Federal Rule of Bankruptcy Procedure ("Bankruptcy Rule") 7012, and should be dismissed.

FN2. The following defendants have not moved to the dismiss the Complaint: Jonathan Greenberg, Morton Kurzrok, Linda Schoenheimer McCurdy, Rosalie Buccellato, Janet Jaffin individually and in her capacity as Trustee of The Janet Jaffin Dispositive Trust, Milton Cooper in his capacity as Trustee of The Janet Jaffin Dispositive Trust, and Elizabeth Moody. Additionally, pursuant to a settlement agreement dated December 7, 2010, the Trustee agreed to withdraw all claims against Robert M. Jaffe and M/A/S Capital Corporation in exchange for $38 million. *See* Stipulation of Dismissal With Prejudice. Dkt. No. 183. Further, Gloria Kurzrok was dismissed without prejudice by so-ordered Stipulation dated April 12, 2010. Dkt. No. 155.

FN3. 15 U.S.C. § 78aaa *et seq.* Hereinafter, "SIPA" shall replace "15 U.S.C." in references to sections of SIPA.

FN4. A SIPA trustee's authority to utilize the Code and the NYDCL derives from SIPA sections 78fff(b) and 78fff–2(c)(3). SIPA section 78fff(b) provides that "[t]o the extent consistent with the provisions of this chapter, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of Title 11." SIPA § 78fff(b). Similarly, SIPA section 78fff–2(c)(3) allows a SIPA trustee to utilize the avoidance powers enjoyed by a bankruptcy trustee: "Whenever customer property is not sufficient to pay in full the claims set forth in subparagraphs (A) through (D) of paragraph (1), the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of Title 11." SIPA § 78fff–2(c)(3).

FN5. N.Y. Debt. & Cred. Law § 270 *et seq.* (McKinney 2001).

FN6. The Trustee has voluntarily dismissed without prejudice Count One of the Complaint, which sought turnover and accounting under section 542 of the Code. *See* Notice of Voluntary Dismissal, Dkt. No. 207. Additionally, although the Trustee apparently seeks to recover preferences from subsequent transferees in Count Nine of the Complaint, Compl. ¶ 142 ("Of the Two Year Transfers, multiple transfers in the collective amount of at least approximately $2,047,402.09 and potentially more were made during the 90 days prior to the Filing Date ... and are additionally recoverable under section[ ] 547...."), this is likely a scrivener's error, as the elements necessary to establish the avoidability of a preference under section 547 of the Code were removed from the Complaint upon amendment.

The instant adversary proceeding seeks over $245 million in connection with prepetition transfers. At the center of the Complaint's allegations is Cohmad Securities Corporation ("Cohmad"), the New York registered broker-dealer that Madoff founded with his friend and former neighbor Sonny Cohn for the purpose of recruiting investors to BLMIS. Cohmad, a compound of the names "Cohn" and "Madoff," provided a central lifeline to BLMIS by referring investors to Madoff since its inception in the mid–1980s. At the time the Madoff Ponzi scheme

collapsed, approximately twenty percent of all active BLMIS accounts were referred by Cohmad. In return, the vast majority of Cohmad's total income was derived from BLMIS. The Trustee seeks to avoid and recover commissions and fees paid by BLMIS to Cohmad and its representatives, as well as fictitious profits that the Moving Defendants withdrew from their BLMIS accounts.

For the reasons set forth below and at oral argument, the Motions to Dismiss are DENIED to the extent set forth herein.

BACKGROUND

A comprehensive discussion of the facts underlying this SIPA liquidation and Madoff's Ponzi scheme is set forth in this Court's prior decisions. *See, e.g., Picard v. Merkin (In re BLMIS),* 440 B.R. 243, 249–51 (Bankr.S.D.N.Y.2010); *SIPC v. BLMIS (In re BLMIS),* 424 B.R. 122, 125–32 (Bankr.S.D.N.Y.2010).

I. PROCEDURAL HISTORY

On December 11, 2008 (the "Filing ***324** Date"),[FN7] Madoff was arrested by federal agents and charged with securities fraud in violation of SIPA sections 78j(b) and 78ff, and 17 C.F.R. section 240.10b–5 in the United States District Court for the Southern District of New York (the "District Court"). *United States v. Madoff,* No. 08–MJ–02735, 2008 WL 5197082 (S.D.N.Y. filed Dec. 11, 2008). That same day, the Securities and Exchange Commission (the "SEC") filed a civil complaint in the District Court alleging, *inter alia,* that Madoff and BLMIS were operating a Ponzi scheme through BLMIS's investment advisor activities. *S.E.C. v. Madoff, et al.,* No. 08–CV–10791, 2008 WL 5197070 (S.D.N.Y. filed Dec. 11, 2008) (the "Civil Action"). Shortly thereafter, the Securities Investor Protection Corporation ("SIPC") filed an application in the Civil Action requesting that the Plaintiff be appointed trustee for the liquidation of the business of BLMIS. On December 15, 2008, the District Court approved SIPC's application, placing BLMIS's customers under the protections of SIPA, and removed the SIPA liquidation proceeding to this Court pursuant to SIPA sections 78eee(b)(3) and (b)(4).

FN7. *See* SIPA § 78*lll* (7)(B) (defining the "Filing Date").

One year later, on December 10, 2009, the District Court denied a motion to withdraw the reference with respect to the instant proceeding and consolidate it with an enforcement action commenced by the Securities and Exchange Commission (the "SEC Action") against, in relevant part, Cohmad, Sonny Cohn, and Marcia Cohn (the "SEC Defendants"). *See Picard v. Cohmad Sec. Corp.,* Nos. 09–CIV–07275, *et al.,* 2009 WL 4729927, at *2 (S.D.N.Y. Dec. 10, 2009). The SEC Action asserted, *inter alia,* violations and aiding and abetting violations of section 10(b) of the Securities and Exchange Act of 1934 and section 17(a) of the Securities Act of 1933 (the "Securities Claims"), and aiding and abetting technical violations of section 15(b)(7) of the Securities and Exchange Act of 1934 and section 206 of the Investment Advisors Act of 1940 (the "Aiding and Abetting Claims"). Although acknowledging "there are concerns which favor withdrawal of the reference," the District Court held that separating claims against the SEC Defendants alone would not reduce discovery or the possibility of inconsistent results, "[n]or would the present litigation in the District Court be simplified by the addition of bankruptcy-law claims to the federal securities law claims." *Id.* All bankruptcy law claims asserted in the instant Complaint therefore remained before this Court.

On February 2, 2010, the District Court dismissed most of the claims in the SEC Action for failure to state a claim. *See SEC v. Cohmad Sec. Corp.,* No. 09–CIV–5680, 2010 WL 363844, at *6, *7 (S.D.N.Y. Feb. 02, 2010). The Securities Claims were dismissed because the "SEC ... failed to allege facts giving rise to a plausible inference of the [SEC Defendants'] fraudulent intent," a required element for securities fraud violations. *Id.* at *6. The District Court dismissed the Aiding and Abetting Claims, holding that the "complaint does not allege that the Cohns held themselves out as [BLMIS] registered representatives or hid their involvement from clients they solicited." *Id.*

Also before the District Court was an action commenced by several investors against Cohmad Representative Delaire, alleging that his fraudulent misstatements and omissions induced them to lose $9.6 million with BLMIS. *See Schulman v. Delaire,* No. 10–CIV–3639, 2011 WL 672002, at *1 (S.D.N.Y. Feb. 22, 2011). The District Court dismissed the Exchange***325** Act and the Securities Act

claims for failure to specify any fraudulent statements or conduct in accordance with Rule 9(b) and dismissed the common law claims for failure to establish that Delaire owed the investors a fiduciary duty. *See id.* at *2–*4.

On August 16, 2010, the Massachusetts Securities Division issued an order against Cohmad for violations of the Massachusetts Uniform Securities Act (the "Act"). *See In re Cohmad Sec. Corp.*, E–2009–0015, 2010 WL 3431832, at *17 (Mass.Sec.Div. Aug. 16, 2010). Cohmad's specific violations included "engaging in unethical or dishonest conduct or practices in the securities business;" failure to reasonably "supervise agents, representatives or other employees to assure compliance with the Act;" and "making or causing to be made in any proceeding under the Act, any statement which is, at the time and in the light of the circumstances under which it is made[,] false or misleading in any material respect." *Id.* As a result, the Massachusetts Securities Division revoked Cohmad's Massachusetts securities registration and fined it $200,000. *Id.*

II. WITHDRAWALS OF FICTITIOUS PROFITS

This Complaint is one of dozens filed by the Trustee seeking the avoidance and recovery of withdrawals of nonexistent profits supposedly earned in investment advisory accounts ("IA Accounts") at BLMIS. Madoff would generate IA Account statements showing securities that either were held or had been traded, as well as the gains and losses in those accounts. None of the purported purchases of securities in the BLMIS customer accounts actually occurred, however, and the reported gains were entirely fictitious ("Fictitious Profits").

The Trustee alleges that all of the Moving Defendants held IA Accounts with BLMIS and seeks to avoid and recover their withdrawals of Fictitious Profits (the "Withdrawals" or "Withdrawals of Fictitious Profits"). These defendants include Cohmad, Sonny Cohn, and Cohmad's Financial Industry Regulatory Authority ("FINRA") registered representatives, as well as certain of their relatives. Specifically, these relatives are Sonny Cohn's wife, who is also the former Vice President and Secretary of Cohmad; Delaire's wife, sister, and father-in-law; Berman's wife; Jalon's wife's estate, of which Jalon is executor; and trusts or joint partnerships established by, or for the benefit of, Cohmad's representatives or these family members. In addition, Withdrawals of Fictitious Profits are sought from the Tenancy Defendants who exchanged transfers to or from the IA Account maintained for the Estate of Elena Jalon. The Complaint states that in excess of $100 million in Fictitious Profits was collectively withdrawn by all named defendants from their respective IA Accounts. Compl. ¶ 138.

III. TRANSFERS OF COMMISSIONS

While a significant portion of the fraudulent transfers identified in the Complaint represent Withdrawals of Fictitious Profits, the majority pertain to payments of BLMIS property allegedly exchanged as fees or commissions for the referral of victims to the BLMIS Ponzi scheme (the "Commissions"). Sonny Cohn and Cohmad were paid such Commissions directly by BLMIS ("Initial Transfers of Commissions"). Cohmad subsequently distributed the vast majority of the payments it received from BLMIS to Marcia Cohn, Delaire, Berman, Cyril Jalon, and Richard Spring, who are or were FINRA registered brokers employed by Cohmad (the "Cohmad Representatives"), as well as other Cohmad representatives not moving to dismiss the Complaint. In sum, only ***326** Cohmad and Sonny Cohn allegedly received Initial Transfers of Commissions, while the Cohmad Representatives are alleged to be subsequent transferees.

Initial Transfers of Commissions paid to Cohmad were based on the net cash value of the accounts procured by the Cohmad Representatives. To track the true cash value of the accounts referred by the Cohmad Representatives, Cohmad and BLMIS set up a cash database (the "Cohmad Cash Database"). The Cohmad Cash Database generated payment schedules detailing, among other information, the annual Commissions due to each Cohmad Representative. If the account holder withdrew all of the funds in the account, the Cohmad Representative would no longer be entitled to receive Commissions. Indeed, Commissions would be debited where investors withdrew more than the principal they invested. Compl. ¶ 75. BLMIS paid one twelfth of the total annual Commissions to Cohmad on a monthly basis as an Initial Transfer of Commissions. Cohmad, in turn, paid these amounts to the respective Cohmad Representatives (the "Subsequent Transfers of Commissions"). Compl. ¶ 59. The Trustee alleges that this payment structure, based on a duel bookkeeping sys-

tem typical of fraudulent enterprises, indicates Cohmad's and the Cohmad Representatives' actual knowledge of fraud. Compl. ¶ 75.

A. Initial Transfers of Commissions to Cohmad

Cohmad was formed for the purpose of recruiting investors for Madoff and, thereby, funneling funds into BLMIS. In exchange, BLMIS would transmit money to Cohmad based upon the actual funds that Cohmad channeled to BLMIS. From January 1996 through 2008, BLMIS paid Initial Transfers of Commissions to Cohmad in an amount of approximately $98,448,678.84. Compl. ¶ 60, Ex. 2.

Just as the name Cohmad could not exist without Cohn and Madoff, Cohmad could not have existed without BLMIS. From a revenue standpoint, BLMIS's payments constituted anywhere from 75.46% to 91.19% of Cohmad's total income per year from 2000–2008. Compl. ¶ 63. In terms of physical proximity, Cohmad was a subtenant of BLMIS, sharing office space on the 18th Floor at 885 Third Avenue. As shown by the floor plan provided in Figure 11 of the Complaint, Cohmad's offices were interspersed among BLMIS's offices, with no physical indication that Cohmad's employees worked for a company other than BLMIS. Compl. ¶ 112. In addition, Cohmad's operational infrastructure was essentially provided by BLMIS. Through BLMIS, Cohmad obtained electricity, market data, exchange fees, access to BLMIS's computer network, and the use of BLMIS's administrative staff. Compl. ¶ 110. More significant assistance came in the form of payments of FICA payroll taxes and the administration of employee benefits, including dental and life insurance plans, for all Cohmad employees. Compl. ¶ 108. One Defendant, Berman, was given a retirement bonus directly from BLMIS even though he was a Cohmad employee. Compl. ¶ 109.

The Trustee asserts that a symbiotic relationship was cultivated by Cohmad's principals' and employees' deliberate obfuscation of any perception that BLMIS and Cohmad operated as separate and distinct entities. The Complaint indicates that individuals employed as registered representatives of Cohmad held themselves out as being employed by BLMIS. Compl. ¶¶ 89–124. Various BLMIS Operating Forms listed one of the Cohmad Representatives as the applicable BLMIS-registered representative for the account, ***327** thereby indicating that the Cohmad Representatives were registered representatives at BLMIS. Cohmad's co-founder, Sonny Cohn, referred to BLMIS's investment principles and strategies as though they were his own when making representations to existing or potential investors. Compl. ¶ 104, Ex. 13. At times, the Cohmad Representatives maintained control over customer accounts after referral by withdrawing funds, transferring funds between accounts, and providing copies of account statements. Compl. ¶ 100.

Cohmad's owners and principals, namely Sonny Cohn and his daughter Marcia Cohn, had unfettered access to Madoff and BLMIS's offices. Marcia Cohn, in particular, had a BLMIS master key, which she used regularly to gain access to the 17th floor, even though her office was located on the 18th floor with the rest of the Cohmad offices. The 17th floor was where the fraudulent activity was taking place, and was "cloaked in mystery." Compl. ¶ 115. Indeed, it was kept off-limits to all but a select few BLMIS employees and family members. Moreover, the IA business on the 17th floor utilized antiquated computers, maintained handwritten logs of cash transactions before entering them manually, and equipped only six of the approximately twenty-one employees with BLMIS e-mail accounts. Compl. ¶¶ 114, 115. Marcia Cohn's key was used to access the 17th floor multiple times, including on the day of Madoff's arrest. Compl. ¶ 113, Ex. 15.

B. Initial Transfers of Commissions to Sonny Cohn

In addition to co-founding Cohmad, Sonny Cohn is its Chairman and Chief Executive Officer. Compl. ¶ 12. The customer accounts he introduced to BLMIS were not reflected on the Cohmad Cash Database, nor was he subject to the same commission structure as the Cohmad Representatives. Rather, after 2002, BLMIS directly compensated Sonny Cohn for luring in new investors and channeling funds into BLMIS. In exchange for these services, BLMIS paid Sonny Cohn Initial Transfers of Commissions totaling approximately $14,601,213.15. Compl. ¶ 61, Ex. 3.

The Trustee further alleges that Sonny Cohn maintained control over the payment structure between BLMIS and Cohmad. To this end, he is alleged to have monitored the balances of customers' accounts that were referred to BLMIS by a Cohmad Representative, and to have directly received Pay-

ment Schedules from BLMIS listing the annual commissions due to each Cohmad Representative. Compl. ¶ 77, Ex. 4. These allegations, the Trustee asserts, reveal that Sonny Cohn was privy to actual negative account balances at times when the account statements reflected gains of Fictitious Profits to the account holder, and he therefore knew or should have known that Madoff was running a Ponzi scheme. The Trustee supports this conclusion by identifying BLMIS account statements provided to customers by Sonny Cohn, which show their account balances with Fictitious Profits in those accounts. Notably, these statements were printed on Cohmad letterhead. Compl. ¶ 103, Ex. 12.

C. Subsequent Transfers of Commissions to Cohmad Representatives

The Trustee alleges that the Initial Transfers of Commissions paid to Cohmad correlates with the sums of money that Cohmad subsequently paid to the Cohmad Representatives. Put another way, nearly all the money that Cohmad received from BLMIS was allocated by Cohmad among the Cohmad Representatives based upon the amount of cash their referrals invested with BLMIS. Compl. ¶ 59. The breakdown***328** of the amounts owed to each Cohmad Representative is detailed in the Payment Schedules contained in Exhibit 4 to the Complaint. Compl. Ex. 4. Each specifies the annual commissions that the Cohmad Representatives earned based upon the amount of money each had under management, with adjustments based on net cash activity that occurred throughout the year. Compl. Ex. 4.

STANDARD OF REVIEW—MOTION TO DISMISS UNDER RULE 12(b)(6)

Rule 12(b)(6) allows a party to move to dismiss a cause of action for "failure to state a claim upon which relief can be granted." FED.R.CIV.P. 12(b)(6); FED. R. BANKR.P. 7012(b). When considering a motion to dismiss under Rule 12(b)(6), a court must accept all factual allegations in the complaint as true and draw all reasonable inferences in the plaintiff's favor. *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S.Ct. 1937, 1949, 173 L.Ed.2d 868 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555–56, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007); *EEOC v. Staten Island Sav. Bank*, 207 F.3d 144, 148 (2d Cir.2000).

To survive a motion to dismiss, a pleading must contain a "short and plain statement of the claim showing that the pleader is entitled to relief." FED.R.CIV.P. 8(a)(2); FED. R. BANKR.P. 7008. However, a recitation of the elements of the cause of action, supported by mere conclusory statements, is insufficient. *Iqbal*, 129 S.Ct. at 1949 ("[T]he tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions."). Rather, "only a complaint that states a plausible claim for relief survives a motion to dismiss." *Id.* at 1950. A claim is facially plausible where "the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* at 1949. In determining plausibility, this Court must "draw on its judicial experience and common sense," *id.* at 1950, to decide whether the factual allegations "raise a right to relief above the speculative level." *Twombly*, 550 U.S. at 555, 127 S.Ct. 1955.

DISCUSSION

I. THE TRUSTEE HAS SUFFICIENTLY PLED ACTUAL FRAUD PURSUANT TO THE CODE AND THE NYDCL

[1] In Counts Two and Four of the Complaint, the Trustee has alleged claims against all of the Moving Defendants to avoid and recover actual fraudulent transfers pursuant to sections 548(a)(1)(A), 544, 550(a) and 551 of the Code and sections 276, 278 and/or 279 of the NYDCL.[FN8] This Court finds that the Trustee has adequately alleged (1) claims to avoid Withdrawals of Fictitious Profits from all Moving Defendants; [FN9] and (2) claims to avoid Initial Transfers of Commissions from Sonny Cohn and Cohmad.

FN8. Cohmad, Sonny Cohn, Marcia Cohn, Milton Cohn and Marilyn Cohn have not moved to dismiss Count Two of the Complaint for actual fraud under the Code. *See* Memorandum of Law of Defendants Cohmad Securities Corporation, Maurice J. Cohn, Marcia B. Cohn, Milton S. Cohn and Marilyn Cohn at p. 11. Dkt. No. 46 ("Cohn Mot. to Dismiss").

FN9. As Cohmad and Jalon withdrew all Fictitious Profits prior to six years before the Filing Date, *see* Compl. Ex 17, the Trustee seeks to avoid and recover their Withdrawals of Fictitious Profits only under the NYDCL through the application of New York's discovery rule. *See infra* Section IV.

> Additionally, as the Guenzburger Tenancy's withdrawals occurred prior to the two year look-back period of the Code, the Trustee seeks to avoid and recover its Withdrawals of Fictitious Profits only under the NYDCL.

***329** [2][3] Actual fraudulent transfer claims brought under either section 548(a)(1)(A) of the Code or section 276 of the NYDCL must meet the heightened pleading requirements of Rule 9(b) of the Federal Rules of Civil Procedure ("Rule 9(b)"). *Am. Tissue, Inc. v. Donaldson, Lufkin & Jenrette Sec. Corp.*, 351 F.Supp.2d 79, 106–07 (S.D.N.Y.2004); *Andrew Velez Const, Inc. v. Consol. Edison Co. of N.Y., Inc. (In re Andrew Velez Const., Inc.)*, 373 B.R. 262, 269 (Bankr.S.D.N.Y.2007). Namely, a trustee must: (1) "state with particularity the circumstances constituting fraud or mistake," but may plead (2) the "[m]alice, intent, knowledge, and other conditions of a person's mind" generally. FED.R.CIV.P. 9(b); FED. R. BANKR.P. 7009.

A. The Trustee Has Identified the Transfers with Particularity Under Rule 9(b)

[4][5][6] Under either the Code or the NYDCL, to state an actual fraudulent transfer claim with Rule 9(b) particularity, a party must ordinarily allege: (1) the property that was conveyed; (2) the timing and, if applicable, frequency of the transfer; and (3) the consideration paid for the transfer. *See United Feature Syndicate, Inc. v. Miller Features Syndicate, Inc.*, 216 F.Supp.2d 198, 221 (S.D.N.Y.2002). However, where the actual fraudulent transfer claim is asserted by a bankruptcy trustee, applicable Second Circuit precedent instructs courts to adopt "a more liberal view ... since a trustee is an outsider to the transaction who must plead fraud from second-hand knowledge." *Nisselson v. Softbank AM Corp. (In re MarketXT Holdings Corp.)*, 361 B.R. 369, 395 (Bankr.S.D.N.Y.2007) (quoting *Picard v. Taylor (In re Park South Sec., LLC)*, 326 B.R. 505, 517–18 (Bankr.S.D.N.Y.2005)) (internal quotations omitted); *see also Shields v. Citytrust Bancorp., Inc.*, 25 F.3d 1124, 1128 (2d Cir.1994). Moreover, in a case such as this one, where "the [T]rustee's lack of personal knowledge is compounded with complicated issues and transactions [that] extend over lengthy periods of time, the trustee's handicap increases," and "even greater latitude" should be afforded. *SIPC v. Stratton Oakmont, Inc.*, 234 B.R. 293, 310 (Bankr.S.D.N.Y.1999).

i. Withdrawals of Fictitious Profits

Here, the essential facts constituting each of the Moving Defendants' Withdrawals of Fictitious Profits are readily identifiable in Exhibits 1 and 17 to the Complaint. Specifically, Exhibit 1 contains an index of the IA Accounts maintained by each of the Moving Defendants, identifying each account by name and account number. Compl. Ex. 1. Each Withdrawal of Fictitious Profits by a Defendant from his or her respective BLMIS IA Account is then identified in Exhibit 17, specifying the date, account number, transferee, transferor, method of transfer and amount transferred. Compl. Ex. 17. To illustrate, on April 10, 2008, the amount of $149,210.46 was withdrawn by Sonny Cohn by check from IA Account number 1C1296.

ii. Initial Transfers of Commissions

Likewise, the Initial Transfers of Commissions paid to Sonny Cohn and Cohmad are identified in Exhibits 2 and 3 to the Complaint, and total over $113 million. Exhibit 2 lists direct payments made by BLMIS to Cohmad for the period of 1996 through 2008, totaling $98,448,678.84. Compl. Ex. 2. Exhibit 3 reflects direct, monthly payments—each in an amount of at least $8,000—from BLMIS to Sonny Cohn between the years 2001 and 2008, totaling approximately $14,601,213.15. Compl. Ex. 3.

Accordingly, the facts contained in the Trustee's exhibits provide this Court with ***330** a sufficient basis to conclude that the Trustee has identified Withdrawals of Fictitious Profits and Initial Transfers of Commissions with requisite particularity.

B. The Trustee Has Adequately Alleged Intent Under Rule 9(b)

Given that the Trustee has identified with requisite particularity the transfers he seeks to avoid under section 548(a)(1)(A) and section 276 of the NYDCL, the next question is whether the Trustee has sufficiently pled the element of fraudulent intent pursuant to Rule 9(b). *See* FED.R.CIV.P. 9(b); FED. R. BANKR.P. 7009 ("[M]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally."). Pursuant to section 548(a)(1)(A) of the Code, a trustee must establish that the debtor "made such transfer ... with actual intent to hinder, delay, or defraud." 11 U.S.C. 548(a)(1)(A). Likewise, under section 276 of the NYDCL, a trustee may avoid any

"conveyance made ... with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors." NYDCL § 276.

Here, the fraudulent intent on the part of the debtor/transferor, as required under both the Code and the NYDCL, is established as a matter of law by virtue of the "Ponzi scheme presumption" as to Withdrawals of Fictitious Profits and Initial Transfers of Commissions. *See Gowan v. The Patriot Grp., LLC (In re Dreier LLP)*, 452 B.R. 391, 434 (Bankr.S.D.N.Y.2011) ("Applying the Ponzi scheme presumption, the Complaint here sufficiently pleads the transferor's actual fraudulent intent [under section 276 of the NYDCL]."); *McHale v. Boulder Capital LLC (In re The 1031 Tax Grp.)*, 439 B.R. 47, 72 (Bankr.S.D.N.Y.2010) ("If the Ponzi scheme presumption applies, actual intent for purposes of section 548(a)(1)(A) is established as a matter of law."). Under this presumption, "[a]ctual intent to hinder, delay or defraud may be established as a matter of law in cases in which the [transferor] runs a Ponzi scheme ... because transfers made in the course of a Ponzi operation could have been made for no purpose other than to hinder, delay or defraud creditors." *Gredd v. Bear Stearns Sec. Corp. (In re Manhattan Inv. Fund Ltd.)*, 359 B.R. 510, 517–18 (Bankr.S.D.N.Y.2007) (" *Manhattan Investment I* "), *aff'd in part and rev'd in part on other grounds*, 397 B.R. 1, ("*Manhattan Investment II*") (S.D.N.Y.2007) ("[T]he Ponzi scheme presumption remains the law of this Circuit."). As this Court has held on previous occasions, the breadth and notoriety of the Madoff Ponzi scheme leave no basis for disputing the application of the Ponzi scheme presumption to the facts of this case, particularly in light of Madoff's criminal admission. *See Chais*, 445 B.R. at 220; *Merkin*, 440 B.R. at 255; *see also Manhattan Investment II*, 397 B.R. at 12 (relying on transferor's criminal guilty plea to establish the existence of a Ponzi scheme). While it is conceivable that "certain transfers may be so unrelated to a Ponzi scheme that the presumption should not apply," the Withdrawals of Fictitious Profits "serve[d] to further [the] Ponzi scheme" and are therefore presumed fraudulent. *Manhattan Investment II*, 397 B.R. at 11. So too are the Initial Transfers of Commissions "clearly tainted as payments from a Ponzi schemer to an individual to reward them for locating new investors." *Id.* at 13.

[7] The Moving Defendants posit that in addition to the debtor/transferor's fraudulent intent, the transferee's fraudulent intent must be established to state a claim under section 276 of the NYDCL. Although this Court previously refrained from determining this issue in the context of other actions arising out of the Madoff ***331** Ponzi scheme, *see Chais*, 445 B.R. at 221 ("Unlike under the Code, under the NYDCL, courts differ as to whether the fraudulent intent of both the transferor and the transferee must be pled."); *Merkin*, 440 B.R. at 257 (same), the analysis since provided by the court in *Dreier* convincingly demonstrates that "it is the transferor's intent alone, and not the intent of the transferee, that is relevant under NYDCL § 276," 2011 WL 2412581, at *32–33. Indeed, the *Dreier* decision explains how the proposition that both parties' fraudulent intent must be established to state a claim for actual fraud under the NYDCL has been unwittingly transformed into an often cited, and blindly accepted, misstatement of the law. *Id.* at *30–32. In concurrence with the reasoning of the *Dreier* court, this Court finds that the statutory text of section 276 and its relationship to the overall framework of the NYDCL support the conclusion that only the fraudulent intent of the debtor/transferor is required to state a *prima facie* claim to avoid actual fraudulent transfers under the NYDCL. *See id.*

For instance, section 276 provides that a trustee can avoid "[e]very conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors...." NYDCL § 276. This is markedly different from NYDCL section 276–a, which allows recovery of attorneys' fees "where such conveyance is found to have been made by the debtor *and received by the transferee* with actual intent." NYDCL § 276–a (emphasis added). Section 276 "makes no reference to the actual fraudulent intent of the transferee and the difference between the provisions cannot be ignored." *In re Dreier LLP*, 2011 WL 2412581, at *32 (internal citations omitted).

[8][9] Further support for this proposition is gleaned from section 278, which provides an affirmative defense to a bona fide purchaser for value without knowledge of the fraud to retain the transfer. *See* NYDCL § 278(2). As an affirmative defense, section 278 requires that the transferee's intent be considered "at the summary judgment phase or at trial on a full

evidentiary record." *In re Dreier LLP*, 2011 WL 2412581, at *33. Therefore, "[i]f the trustee meets the evidentiary burden of proving a prima facie case of actual fraud ... the burden shifts to the transferee to establish the affirmative defense...." *Id.* Accordingly, a defendant's good faith "need not be negated by the Trustee in the Complaint." *Id.* (quoting *Stratton Oakmont, Inc.*, 234 B.R. at 318).

Because the foregoing interpretation "aligns the fraudulent intent pleading requirement under Bankruptcy Code § 548(a)(1)(A) and NYDCL § 276," the element of fraudulent intent under both statutes is met by virtue of the Ponzi scheme presumption. *Id.* at *28. Therefore, the Moving Defendants' arguments that they accepted transfers in good faith and in exchange for value will become relevant only as affirmative defenses to be asserted at trial under section 548(c) of the Code and section 278 of the NYDCL. *See Mendelsohn v. Jacobowitz (In re Jacobs)*, 394 B.R. 646, 659 (Bankr.E.D.N.Y.2008) ("An innocent purchaser must affirmatively show good faith in order to take advantage of [NYDCL] section 278(2)."); *Bayou Superfund LLC v. WAM Long/Short Fund II LP (In re Bayou Grp., LLC)*, 362 B.R. 624, 631 (Bankr.S.D.N.Y.2007) ("The good faith/value defense provided in Section 548(c) is an affirmative defense, and the burden is on the defendant-transferee to plead and establish facts to prove the defense.").

***332** For aforementioned reasons, the Court finds the Trustee has adequately pled claims under section 548(a)(1)(A) of the Code and section 276 of the NYDCL to avoid and recover Withdrawals of Fictitious Profits and Initial Transfers of Commissions. Accordingly, the Motions to Dismiss Counts Two and Four of the Complaint are denied.[FN10]

> FN10. The portion of Count Four requesting attorneys' fees pursuant to section 276–a of the NYDCL need not be stricken at this time. While the transferee's intent is an element of a claim under section 276–a, unlike under section 276, attorneys' fees will be recoverable provided that the Trustee establishes fraudulent intent on the part of the defendants at trial. *See In re Dreier LLP*, 2011 WL 2412581, at *33 ("If the Trustee is unable to develop through discovery evidence of actual fraud by [d]efendants, the portion of [the Complaint] requesting attorneys' fees can be dismissed before trial or following trial.").

II. THE TRUSTEE HAS SUFFICIENTLY PLED CONSTRUCTIVE FRAUD PURSUANT TO THE CODE AND THE NYDCL

[10] The Trustee has sufficiently pled Counts Three, Five, Six and Seven of the Complaint pursuant to sections 548(a)(1)(B), 544, 550(a), and 551 of the Code and sections 273–275, 278, and/or 279 of the NYDCL to avoid and recover transfers on the basis that they were constructively fraudulent against (1) all of the Moving Defendants [FN11] with respect to Withdrawals of Fictitious Profits; and (2) Sonny Cohn and Cohmad with respect to Initial Transfers of Commissions.

> FN11. As noted previously, the Trustee seeks to avoid and recover the Withdrawals of Fictitious Profits from Cohmad and Jalon only under the NYDCL through the application of New York's discovery rule, and from the Guenzburger Tenancy only under the NYDCL. *See supra* n.9.

[11][12] Under both the Code and the NYDCL, courts consistently hold that "claims of constructive fraud do not need to meet the heightened pleading requirements of Fed.R.Civ.P. 9(b)." *Bank of Commc'ns v. Ocean Dev. Am., Inc.*, No. 07–CIV–4628, 2010 WL 768881, at *6 (S.D.N.Y. Mar. 8, 2010); *Enron Corp. v. Granite Constr. Co. (In re Enron Corp.)*, No. 03–93172, 2006 WL 2400369, at *5 (Bankr.S.D.N.Y. May 11, 2006) ("The Court does not see any reason to break with its precedent in applying Rule 8(a) in evaluating the pleadings in a constructive fraudulent conveyance matter herein."); *Stratton Oakmont, Inc.*, 234 B.R. at 319 ("The pleading of constructive fraud [under the NYDCL], as opposed to actual fraud, must only comply with F.R.C.P. 8(a)...."). Rather, the Trustee need only satisfy Rule 8(a) by providing a "short and plain statement of the claim showing that [he] is entitled to relief." FED.R.CIV.P. 8(a)(2). The purpose of this pleading requirement is to ensure that the defendant receives "fair notice of what the ... claim is and the grounds upon which it rests." *Scheidelman v. Henderson (In re Henderson)*, 423 B.R. 598, 612 (Bankr.N.D.N.Y.2010) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 545, 127 S.Ct. 1955, 167

L.Ed.2d 929 (2007)) (internal quotations omitted). Therefore, "the sole consideration should be whether, consistent with the requirements of Rule 8(a), the complaint gives the defendant sufficient notice to prepare an answer, frame discovery and defend against the charges." *Nisselson v. Drew Indus., Inc. (In re White Metal Rolling & Stamping Corp.)*, 222 B.R. 417, 429 (Bankr.S.D.N.Y.1998) (internal citations omitted).[FN12]

> FN12. The Court is not persuaded that the Trustee's claims to avoid Initial Transfers of Commissions against Cohmad and Sonny Cohn must be dismissed for failure to meet a heightened Rule 9(b) standard. *See* Cohn Mot. to Dismiss at pp. 18–19 ("Because the Trustee's allegations of lack of good faith sound in fraud, they must be pleaded with particularity in accordance with Rule 9(b)'s requirements."). Indeed, the Second Circuit has indicated that Rule 8(a) applies to constructive fraud claims even where the court considers the transferee's knowledge of the fraud and underlying actions. *See Sharp Int'l Corp. v. State St. Bank & Trust Co. (In re Sharp Int'l Corp.)*, 403 F.3d 43, 53–54 (2d Cir.2005) (discussing constructive fraud and raising Rule 9(b) only in subsequent discussions of actual fraud); *Silverman v. Actrade Capital, Inc. (In re Actrade Fin. Techs. Ltd.)*, 337 B.R. 791, 801 (Bankr.S.D.N.Y.2005) ("[I]n [*Sharp*], the Second Circuit considered a motion to dismiss a complaint that asserted claims of constructive and intentional fraudulent conveyance under New York State law. It held that the intentional fraud claims had to be pleaded in compliance with Rule 9(b) but did not imply that the constructive fraud claims had to meet any such requirement."); *see also Eclaire Advisor Ltd. v. Daewoo Eng'g. & Constr. Co.*, 375 F.Supp.2d 257, 268 (S.D.N.Y.2005) ("[T]his [constructive fraud claim] is not the kind of fraud to which Rule 9(b) applies.").

***333 A. The Complaint Gives the Moving Defendants Requisite Notice to Defend Against the Trustee's Constructive Fraudulent Transfer Claims Under Rule 8(a)**

Section 548(a)(1)(B) of the Code requires the Trustee to show, *inter alia,* that BLMIS did not receive "reasonably equivalent value" for the transfer. 11 U.S.C. § 548(a)(1)(B). Under sections 273–275 of NYDCL, the Trustee must show that BLMIS did not receive "fair consideration," which can be established by showing either a lack of "fair equivalent" property—which is essentially reasonably equivalent value under the Code—or a lack of good faith on the part of the transferee. NYDCL § 272 (defining "fair consideration"); *In re Dreier LLP*, 2011 WL 2412581, at *39 ("To defeat a motion to dismiss, the Trustee need only allege a lack of 'fair consideration' by pleading a lack of 'fair equivalent' value *or* a lack of good faith on the part of the transferee."); *Balaber–Strauss v. Sixty–Five Brokers (In re Churchill Mortg. Inv. Corp.)*, 256 B.R. 664, 677 (Bankr.S.D.N.Y.2000) (*Churchill I*) (" '[R]easonably equivalent value' in Section 548(a)(1)(b), [and] 'fair consideration' in the [NYDCL] ... have the same fundamental meaning.").

i. Withdrawals of Fictitious Profits

[13] The Trustee has sufficiently alleged that no value was provided in exchange for the Moving Defendants' Withdrawals of Fictitious Profits. Courts have consistently held that transfers received in a Ponzi scheme in excess of an investor's principal are not transferred for reasonably equivalent value. *Sender v. Buchanan (In re Hedged–Inv. Assoc., Inc.)*, 84 F.3d 1286, 1290 (10th Cir.1996) (holding payments in excess of original investment do not provide any value); *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir.1995) ("The paying out of profits to [the defendant] not offset by further investments by him conferred no benefit on the corporations...."); *In re Dreier LLP*, 2011 WL 2412581, at *37 n. 44 ("The Court's conclusion that the Defendants did not provide 'reasonably equivalent value' for the payments in excess of principal is consistent with those courts that have held that investors in a Ponzi scheme are not entitled to retain the fictitious profits they received."). Thus, when investors invest in a Ponzi scheme, any payments that they receive in excess of their principal investments can be avoided by the Trustee as fraudulent transfers. *See Donell v. Kowell*, 533 F.3d 762, 770 (9th Cir.2008) ("[T]he general rule is that to the extent innocent investors have received payments in excess of the amounts of principal that they originally invested, those payments are avoidable as fraudulent transfers."); *In re Bayou Grp., LLC*, 439 B.R. at 338 ***334** ("Because Appellants provided no value in exchange for the fictitious profits they received, that portion of their redemption payments is

voidable as a constructive fraudulent conveyance."); *Churchill I*, 256 B.R. at 683 (noting the general rule that distributions in excess of principal constitute fraudulent transfers subject to avoidance).

Here, the Trustee has sufficiently pled that the Withdrawals consisted solely of Fictitious Profits, and were therefore not received in exchange for reasonably equivalent value. Compl. ¶ 138 ("Upon information and belief, Cohmad, the Cohmad Representatives and other Defendants have received in excess of $100,000,000.00 *in Fictitious Profits.*") (emphasis added). Moreover, the Complaint identifies each Withdrawal of Fictitious Profits so as to provide the Moving Defendants with fair notice of the transfers sought to be avoided. Compl. Ex. 17; *see also supra* Section I, A, i.

Accordingly, the Trustee has adequately stated a claim for constructive fraudulent transfers under the Code and the NYDCL against all Moving Defendants with regard to Withdrawals of Fictitious Profits.

ii. Initial Transfers of Commissions

[14] In determining whether Cohmad and Sonny Cohn conferred sufficient value in exchange for the Initial Transfers of Commissions, the Court must ultimately examine the totality of the circumstances, including "the arms-length nature of the transaction; and ... the good faith of the transferee." *Pereira v. Wells Fargo Bank, N.A (In re Gonzalez)*, 342 B.R. 165, 173 (Bankr.S.D.N.Y.2006); *see also Armstrong v. Collins*, Nos. 01–CIV–2437, *et al.*, 2010 WL 1141158, at *29 (S.D.N.Y. Mar. 24, 2010) ("In determining whether reasonably equivalent value has been provided for a transfer, courts delve beyond form to the substance of the transaction.") (internal quotations omitted); *Am. Tissue, Inc.*, 351 F.Supp.2d at 106 (explaining that value "depends on all the circumstances surrounding the transaction") (internal quotations omitted). In this case, where the reasonably equivalent value analysis requires more than a simple math calculation, it is inappropriate at the motion to dismiss stage. *See Global Crossing Estate Rep. v. Winnick*, No. 04–CIV–2558, 2006 WL 2212776, at *9 (S.D.N.Y. Aug. 03, 2006) ("[T]he question whether 'fair consideration' was received is a factual one, and thus even where on the surface it would appear that such is the case (for example, the [defendants] point out that during the period, [the debtor] managed to raise billions of dollars in capital, precisely what it had asked the [defendants] to accomplish, it would be premature to dismiss these claims.")); *In re Actrade Fin. Techs. Ltd.*, 337 B.R. at 804 ("[T]he question of 'reasonably equivalent value' ... is fact intensive, and usually cannot be determined on the pleadings.").

Cohmad and Sonny Cohn nevertheless argue, unpersuasively, that the Trustee's constructive fraudulent transfer claims fail as a matter of law because their services constituted reasonably equivalent value and fair consideration given to BLMIS. In support of this contention, they rely principally upon the case of *In re Churchill Mortgage Inv. Corp.*, where the court found that the brokers provided value by performing their duties in exchange for the commissions received. 256 B.R. at 667, *aff'd*, *Balaber–Strauss v. Lawrence*, 264 B.R. 303 (S.D.N.Y. July 9, 2001) (*Churchill II*). [FN13] Cohmad and Sonny ***335** Cohn ignore that the *Churchill* court explicitly limited its holding to undisputedly "innocent" brokers:

> FN13. In *Churchill*, the trustee sought to avoid commissions paid to brokers by a debtor that ran a fraudulent scheme. The Trustee's sole argument was that the brokers' services were actually detrimental to the debtor in that each investor they brought in deepened the debtor's insolvency. 256 B.R. at 680. The court rejected this argument and held that "value" is dependent upon the specific transactions at issue between the debtor and transferees, and not on the overall impact of the services on the debtor's financial condition. Finding that the brokers performed their duties as required, the court held that the commissions could not be avoided as fraudulent conveyances. *Id.* ("[T]he Brokers in these cases were hired and paid to produce mortgages or investors. They produced and thereby gave value....").

It is important here to note what the Trustee does *not* allege. There is no allegation in the complaints and no claim by the Trustee that the Brokers had any knowledge of the Ponzi scheme. There is no allegation in the complaints and no claim by the Trustee that any of the Brokers' activities were fraudulent, or unlawful, or wrongful in any manner.

256 B.R. at 673–74; *see also id.* at 674 ("It is also

assumed that the Brokers had no knowledge of the Ponzi scheme, and that the Brokers' own activities were not unlawful or wrongful in any respect."); *id.* at 680 ("They earned what they were paid fairly and *without wrongdoing.*") (emphasis added). The issue before the court was narrowly defined as whether "[b]rokers [may] be held liable to repay commissions, which *they earned in good faith* ... merely because the Debtors' management was *independently* engaged in a fraudulent enterprise[.]" *Id.* at 675 (emphasis added). Indeed, in affirming *Churchill,* the District Court likewise emphasized, and it was undisputed by the parties, that "[t]he Brokers in this case performed *innocent* services.... The Debtors received 'value' in exchange for the commissions paid to the Brokers for performing *in good faith a facially lawful and customary service....*" *Churchill II,* 264 B.R. at 308 (emphasis added).

Here, unlike in *Churchill,* the Complaint alleges a lack of innocence on the parts of Sonny Cohn and Cohmad, through its officers and directors.[FN14] *See In re Bayou Grp., LLC,* 362 B.R. at 637 (noting bad faith investors' reliance on *Churchill* was misplaced because "[i]t was not alleged [in *Churchill*] that any of the brokers had any knowledge of the fraud perpetrated by the Churchill entities"). According to the Complaint, the interconnection between Cohmad and BLMIS was so pervasive that they appeared to be arms of the same enterprise—the name "Cohmad" itself embodies the union between Sonny Cohn and ***336** Madoff.[FN15] Cohmad and BLMIS shared office space wherein Cohmad employees worked side-by-side with BLMIS employees. Marcia Cohn even maintained a BLMIS master key that granted her access to the mysterious 17th floor, the purported nucleus of the fraud. Exhibit 17 illustrates that Marcia Cohn utilized the BLMIS master key on numerous occasions, including on the day of Madoff's arrest. Compl. Ex. 17. Cohmad procured its utility services, market data and exchange fees, computer network, telephone, and other services through BLMIS. To potential investors, Cohmad Representatives held themselves out to be representatives of Madoff and/or BLMIS, and they were often listed on BLMIS account opening forms as the BLMIS representative. Indeed, BLMIS and Cohmad were so intertwined that many of the victims introduced to BLMIS through Cohmad had never heard of Cohmad. Compl. ¶ 89.

FN14. The Trustee has alleged that Sonny is an owner of Cohmad and serves as the Chairman and Chief Executive Officer, and that Marcia Cohn is an owner of Cohmad and serves as President, Chief Operating Officer, and Chief Compliance Officer. Thus, Cohmad can be charged with any fraudulent knowledge attributable to Sonny and Marcia based on general principles of New York agency law. *See, e.g., Bondi v. Bank of Am. (In re Parmalat),* 383 F.Supp.2d 587, 597 (S.D.N.Y.2005) ("The acts performed and knowledge acquired by a corporate officer or agent are imputed to the corporation where the officer or agent was acting within the scope of his or her employment."); *SEC v. Ballesteros Franco,* 253 F.Supp.2d 720, 729 (S.D.N.Y.2003) ("[A]corporation can act only through the actions of natural persons and that the actions of its agents, acting within the scope of their agency, are attributed to the corporation."). As imputation is based on basic agency principles and not corporate veil piercing, and as none of the causes of action or remedies sought in the Complaint requires that the Moving Defendants be alter egos of their associated corporations, the Court need not address the arguments of Cohmad, Sonny Cohn, and Marcia Cohn that the Trustee has inadequately alleged claims for alter ego and corporate veil piercing.

FN15. Madoff, with the knowledge of Sonny and Marcia Cohn, allegedly utilized Cohmad to funnel money to Sonja Kohn, an individual that was not a Cohmad Representative or otherwise affiliated with Cohmad. *See* Compl. ¶¶ 76, 120–24, Ex. 4.

Sonny Cohn, in particular, provided account statements to certain customers with BLMIS account balance information, including fictitious profits, and purported to manage the BLMIS accounts. Compl. ¶ 103, Ex. 12. He described Madoff's activities to customers as though they were Cohmad's, stating Cohmad manages customer accounts "using a simplistic, and most important, a very conservative strategy in a disciplined manner, always 'insuring' the accounts against major loss by using put options." Compl. ¶ 99, Ex. 9. In one instance, Sonny Cohn is

listed as the account representative on a BLMIS account that was not even referred by a Cohmad Representative. Compl. ¶ 97–98. While Sonny Cohn purports to have worked for Cohmad, he did not receive commissions through Cohmad after 2002, but instead was paid directly from BLMIS.[FN16]

> FN16. The Complaint at issue here differs from the complaint dismissed in *SEC v. Cohmad* and is substantially buttressed by law and fact. First, the legal standard applicable to the bankruptcy claims asserted in the instant Complaint is not equivalent to that of the securities law claims dismissed by the District Court. As an element of its *prima facie* case for the Securities Claims, the SEC was required to plead scienter, or fraudulent intent, on the part of the SEC Defendants. *See* SEC v. Cohmad Sec. Corp., 2010 WL 363844, at *3. By contrast, the avoidance actions asserted in the instant Complaint do not require the Trustee to establish fraudulent intent on the part of the transferees at this stage of the proceedings. *See, e.g.*, *In re Dreier LLP*, 2011 WL 2412581, at *32; *In re Enron Corp.*, 2006 WL 2400369, at *5 (explaining that scienter is not an element of constructive fraud); *Stratton Oakmont, Inc.*, 234 B.R. at 319 (same). Second, many of the above allegations were not presented to the District Court in the SEC Action. For example, there was no mention of Marcia Cohn's unfettered access to the 17th floor, Sonny Cohn's and the Cohmad Representatives' portrayal of themselves as BLMIS employees, their continuing role in account maintenance, or the transfers to Sonja Kohn. The allegations here, which are not evaluated under the securities law standard of scienter considered in the SEC Action, are sufficient under applicable case law to raise the curtain for discovery into the Trustee's claims.

Taking these allegations as true for purposes of the Motions to Dismiss, the Court cannot conclude as a matter of law that Cohmad and Sonny Cohn provided reasonably equivalent value by "performing in good faith a facially lawful and customary service," *Churchill II*, 264 B.R. at 308, for a separate entity "independently engaged" in operating a Ponzi scheme, *Churchill I*, 256 B.R. at 675; *see also Rieser v. Hayslip (In re Canyon Sys. Corp.)*, 343 B.R. 615, 645–46 (Bankr.S.D.Ohio 2006) (holding ***337** that even under *Churchill*, brokers failed to give reasonably equivalent value where they were insiders or related to insiders of the debtor and therefore presumably familiar with the debtor's scheme). As a result, "[i]t would ... be premature to dismiss the [fraudulent transfer] claim[s] on the ground that the value transferred to [the debtor] appears, in simple mathematical terms, to exceed that of the allegedly fraudulent transfers." *Am. Tissue, Inc.*, 351 F.Supp.2d at 106. At this stage, the Trustee has plausibly alleged a lack of innocence sufficient to distinguish *Churchill* and raise the curtain for discovery into the value, if any, given by Cohmad and Sonny Cohn in exchange for their receipt of Commissions.

Consequently, the Trustee has adequately pled his constructive fraud claims against Cohmad and Sonny Cohn, and the Motions to Dismiss Counts Three, Five, Six and Seven of the Complaint are denied.

III. THE TRUSTEE HAS PROPERLY ALLEGED THAT THE RELEVANT DATE FOR SIX YEAR FRAUDULENT CONVEYANCES UNDER THE NYDCL IS THE FILING DATE OF THE SIPA PROCEEDING

[15] With respect to the Trustee's fraudulent conveyance actions under the NYDCL, the Court finds that the relevant look-back period extends to those transfers made as early as December 11, 2002, six years before the December 11, 2008 Filing Date of the SIPA liquidation proceeding. *See* Compl. ¶ 8.

The Moving Defendants argue that the statute of limitations for fraudulent conveyance actions under section 213(8) of the New York Civil Procedure Law and Rules (the "NYCPLR"),[FN17] incorporated by reference in section 544(b) of the Code, looks back six years from the filing of the *Complaint,* filed on June 22, 2009, rather than from the *Filing Date,* December 11, 2008. In effect, the Moving Defendants challenge the Trustee's attempts to recover those Transfers made in the period between December 11, 2002 and June 22, 2003.

> FN17. Section 213(8) of the NYCPLR states, in relevant part, that the statute of limitation for bringing causes of action

sounding in fraud is six years. NYCPLR § 213(8).

The issue raised by the Moving Defendants, centering on the interplay between the state statute of limitation periods incorporated by sections 544(b) and 546(a) of the Code, has been determined by this Court as a matter of law in previous decisions. *See, e.g., Chais,* 445 B.R. at 220. In concurrence with the weight of authority, this Court concluded that "upon the filing of a bankruptcy case, state law statutes of limitation cease to have any continued effect, and, instead, the provisions of section 546(a) of the Code govern," allowing a trustee to recover transfers made six years before the Filing Date. *Id.* at 231. Courts have held that as long as the statute of limitations has not expired as of the petition date, a trustee is permitted to bring New York fraudulent conveyance actions looking back six years from the Filing Date in accordance with section 544(b) at *any* point during the two-year period set out in section 546(a). *See, e.g., Barnard v. Joffe (In re Inflight Newspapers, Inc.),* 423 B.R. 6, 20 (Bankr.E.D.N.Y.2010) ("[T]he operative date for determining the look-back period for recovering a transfer is the *petition date.*") (emphasis added); *O'Connell v. Shallo (In re Die Fliedermaus LLC),* 323 B.R. 101, 107 (Bankr.S.D.N.Y.2005) ("This would permit the Trustee to reach back to October 3, 1995, *six years before the Debtor's bankruptcy petition was filed.*") (emphasis added). Construing section 546(a) of the Code and the applicable state statute of limitation ***338** period in this manner fosters a trustee's ability to recover property for the benefit of the estate—a congressional goal intended to be achieved by the Code. *See Summit Sec. Inc. v. Sandifur (In re Metro. Mortg. & Sec. Co., Inc.),* 344 B.R. 138, 141 (Bankr.E.D.Wash.2006).

Accordingly, the Trustee may avoid those transfers made as early as December 11, 2002, six years before the December 11, 2008 Filing Date. Counts Four, Five, Six and Seven of the Complaint seeking transfers going back six years from the Filing Date are therefore timely and have been properly pled. [FN18]

FN18. In addition, even if the Moving Defendants' position were correct, the Trustee may nonetheless avoid the Transfers that occurred in the disputed period between December 11, 2002 and June 22, 2003 due to New York's "discovery rule," which is discussed in detail in Section IV.

IV. THE TRUSTEE HAS SUFFICIENTLY PLED CLAIMS FOR TRANSFERS PRIOR TO SIX YEARS BEFORE THE FILING DATE BASED ON THE DISCOVERY RULE

[16] The Trustee has sufficiently pled Count Eight of the Complaint [FN19] pursuant to sections 213(8) and 203(g) of the NYCPLR, sections 276, 278 and/or 279 of the NYDCL, and sections 544, 550(a) and 551 of the Code, to recover actual fraudulent transfers from the Defendants made more than six years before the Filing Date pursuant to New York's "discovery rule." [FN20]

FN19. Cohmad, Sonny Cohn, Marcia Cohn, Milton Cohn and Marilyn Cohn have not moved to dismiss Count Eight of the Complaint for undiscovered fraudulent transfers. *See* Cohn Mot. to Dismiss at pp. 29–31.

FN20. The "discovery rule" contained in the NYCPLR states that for causes of action predicated on fraud, "the time within which the action must be commenced shall be the greater of six years from the date the cause of action accrued or two years from the time the plaintiff or the person under whom the plaintiff claims discovered the fraud, or could with reasonable diligence have discovered it." NYCPLR § 213(8); *see also id.* at § 203(g) ("[T]he action must be commenced within two years after such actual or imputed discovery or within the period otherwise provided, computed from the time the cause of action accrued, whichever is longer.").

The Trustee seeks to utilize New York's discovery rule, in conjunction with his strong arm power under section 544 of the Code and applicable sections of the NYDCL, to avoid "undiscovered transfers" that occurred more than six years before the Filing Date. To do this, the Trustee must show that during the period various transfers were made, Madoff's fraud was either: (1) not discovered, and could not have been discovered with reasonable diligence, by at least one unsecured creditor; or (2) was only discovered, and could have only been discovered with reasonable diligence, by at least one unsecured creditor within two years of the Filing Date. NYCPLR §§

213(8), 203(g); *see also Phillips v. Levie*, 593 F.2d 459, 462 n. 12 (2d Cir.1979); *Silverman v. United Talmudical Acad. Torah Vyirah, Inc. (In re Allou Distribs., Inc.)*, 446 B.R. 32, 67 (Bankr.E.D.N.Y.2011) ("New York state law fixes the limitations period for claims under the DCL. A claim based on actual fraud under DCL Section 276 must be brought within the later of six years from the date of the fraud or conveyance, or two years from the date that the fraud should have been discovered.").

One of the Moving Defendants argues that the Trustee lacks standing to assert this cause of action under section 544 of the Code because he has failed to identify a specific unsecured creditor who could invoke the discovery rule. *See* Memorandum of Law in Support of Motion to Dismiss***339** Adversary Proceeding of Defendant Jane Delaire Hackett pp. 29–31. Dkt. No. 66. In *Picard v. Chais*, this Court rejected a virtually identical argument on the grounds that courts in this district have held that a trustee need only identify a category of unsecured creditors to assert a claim under section 544(b). *See* 445 B.R. 206, 234 (Bankr.S.D.N.Y.2011); *see also Global Crossing*, 2006 WL 2212776, at *11 ("[T]here is no authority for the proposition that the Estate Representative must be more specific than to identify the category of creditors with potentially viable claims."); *In re RCM Global Long Term Cap. Apprec. Fund, Ltd.*, 200 B.R. 514, 523–24 (Bankr.S.D.N.Y.1996) (holding that pleading the existence of an unsecured creditor with an allowable claim is sufficient to plead a claim under section 544(b)).

The Complaint sufficiently alleges the existence of a category of creditors who could invoke the discovery rule. Indeed, it states that "[a]t all times relevant to the Transfers, the fraudulent scheme perpetrated by BLMIS was not reasonably discoverable by at least one unsecured creditor of BLMIS," Compl. ¶ 185, and that "[a]t all times relevant to the Transfers, there have been one or more creditors who have held and still hold matured or unmatured unsecured claims against BLMIS that were and are allowable...." Compl. ¶ 186. These allegations alone provide the Moving Defendants with sufficient notice of the existence of at least one category of creditors on whose claims the Trustee bases his standing: the clearly defrauded BLMIS customers. *See* Compl. ¶ 7 ("The Trustee seeks to set aside such transfers and preserve the property for the benefit of all of BLMIS' defrauded customers.").

Even putting that aside, Second Circuit precedent suggests that adjudicating this issue is most likely premature at the motion to dismiss stage. *See Schmidt v. McKay*, 555 F.2d 30, 37 (2d Cir.1977) (holding that whether a plaintiff knew or could have known with reasonable diligence of fraud is a mixed question of law and fact that "ordinarily should not be disposed of by summary disposition"); *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 673 (D.R.I.1998) ("A probing inquiry into who the creditors are, and what claims they hold, is inappropriate [on a motion to dismiss]."); *Trepuk v. Frank*, 44 N.Y.2d 723, 725, 405 N.Y.S.2d 452, 376 N.E.2d 924 (N.Y.1978) ("Where it does not conclusively appear that a plaintiff had knowledge of facts from which the fraud could reasonably be inferred, a complaint should not be dismissed on motion and the question should be left to the trier of the facts.").

On the basis of the aforementioned allegations and applicable precedent, this Court finds that the Trustee has properly alleged claims to avoid actual fraudulent transfers to the extent such claims were commenced within two years of the reasonable discovery of the fraud in accordance with the New York discovery rule, and, in any event, this issue will be more fully determined after discovery upon summary judgment or a trial on the merits.

V. THE TRUSTEE HAS ADEQUATELY PLED CLAIMS TO RECOVER SUBSEQUENT TRANSFERS FROM THE COHMAD REPRESENTATIVES

[17] The Trustee has sufficiently pled Count Nine of the Complaint to recover Subsequent Transfers of Commissions from the Cohmad Representatives pursuant to sections 550(a)(2) of the Code and 278 of the NYDCL. *See* 11 U.S.C. § 550(a)(2) ("[T]o the extent that a transfer is avoided ... the trustee may recover ... the property transferred ... from ... any immediate or mediate transferee of such initial transferee."); NYDCL § 278 ***340** (allowing recovery from "any person"); *Farm Stores, Inc. v. Sch. Feeding Corp.*, 102 A.D.2d 249, 255, 477 N.Y.S.2d 374 (App.Div.2d Dep't 1984) ("[E]ach transferee ... is liable to the creditor to the extent of the value of the money or property he or she wrongfully received.").

The Cohmad Representatives, all apparently assuming that the Trustee seeks to avoid their Commissions as initial transferees of fraudulent transfers, argue that the Complaint does not contain factual allegations supporting their awareness of the fraud, and, pursuant to *Churchill,* their commissions are therefore not avoidable. However, because the Trustee seeks to recover Commissions from the Cohmad Representatives as subsequent transferees, not initial transferees, the Trustee need not prove a *prima facie* case of avoidability against them. Compl. ¶ 191. ("On information and belief ... the Commissions[ ] were subsequently transferred by Cohmad directly or indirectly to the Cohmad Representatives ... in the form of payment of commissions or fees."); *see also* Stratton Oakmont, Inc., 234 B.R. at 318 ("The Trustee need not allege that Nancy or Nadine, as [subsequent] transferees, intended to defraud Stratton....").

In order to adequately state his claims against the Cohmad Representatives to recover Subsequent Transfers of Commissions under the Code or the NYDCL, the Trustee need only meet a Rule 8(a) standard. *See* Stratton Oakmont, Inc., 234 B.R. at 317 ("[R]ecovery under § 550(a) is not subject to a particularized pleading standard...."). Indeed, as one court explained, the Trustee's present burden "is not so onerous as to require dollar-for-dollar accounting of the exact funds at issue." Silverman v. K.E.R.U. Realty Corp. (In re Allou Distribs., Inc.), 379 B.R. 5, 30 (Bankr.E.D.N.Y.2007) (internal quotations omitted); *see also* IBT Int'l, Inc. v. Northern (In re Int'l Admin. Servs.), 408 F.3d 689, 708 (11th Cir.2005) (same). Nevertheless, to establish that the Cohmad Representatives are subsequent transferees, the Complaint must "set forth the 'necessary vital statistics—the who, when, and how much' " of the purported transfers. In re Dreier LLP, 2011 WL 2412608 at *10 (citing In re Allou Distribs., Inc., 379 B.R. at 32); *see also* Buchwald Capital Advisors LLC v. JP Morgan Chase Bank, N.A. (In re Fabrikant & Sons, Inc.), No. 06–12737, 2009 WL 3806683, at *16 (Bankr.S.D.N.Y. Nov. 10, 2009) (dismissing in large part the second amended complaint because "it continues to lump transfers ... and fails to particularize the initial transfers or subsequent transfers"). At the very least, the Trustee must plead a statement of facts that "adequately apprises" the Cohmad Representatives of the Subsequent Transfers of Commissions he seeks to recover. Stratton Oakmont, Inc., 234 B.R. at 317–18 (identifying the pleading requirements set forth under Rule 8(a)).

The information contained in the Complaint and the exhibits attached thereto provide more than enough detail to provide the Cohmad Representatives with notice of when, in what amount, with what frequency and from whom they received Subsequent Transfers of Commissions, as well as why. As discussed previously, the Initial Transfers of Commissions from BLMIS to Cohmad are set forth with particularity in Exhibits 2 and 3 to the Complaint, specifying the dates upon which they took place. Compl. Exs. 2, 3. The Trustee further alleges that each one of these transfers was essentially a composite of the Subsequent Transfers of Commissions that BLMIS agreed to pay each Cohmad Representative. As set forth in Exhibit 4, BLMIS states the separate amounts of Commissions due to each Cohmad Representative based on the monies ***341** that their respective clients invested with BLMIS. Compl. Ex. 4. To illustrate, for the period of January 16, 2007 to January 15, 2008, the relevant Payment Schedule reflects that BLMIS calculated Alvin J. Delaire's commissions to be $536,274.36, based upon his referrals under management in the amount of $170,504,951.62, with adjustments due to cash net activity during the period.[FN21] Compl. ¶ 76, Fig. 1; Compl. Ex. 4. In short, the Trustee alleges that the amounts of Commissions specified by BLMIS on the Payment Schedules correspond to the amounts paid by BLMIS to Cohmad and, subsequently, to the Cohmad Representatives. Compl. ¶ 79. These allegations apprise the Cohmad Representatives of "which transactions are claimed to be fraudulent and why, when they took place, how they were executed and by whom." Stratton Oakmont, Inc., 234 B.R. at 318.

FN21. In addition to Delaire, the Payment Schedule for 2008 specifies: (1) Cyril Jalon ("CJ") had $11,374,555.68 under management and was designated $25,777.05 after adjustments; (2) Marcia Cohn ("MBC") had $65,179,600.48 under management and was designated $180,449.73 after adjustments; and (3) Richard Spring ("RS") had $523,229,607.56 under management and was designated $1,145,763.60 after adjustments. Compl. ¶ 76, Fig. 1; Compl. Ex. 4. Although Berman does not appear on the 2008 Payment Schedules, he appears on var-

> ious others, including the Payment Schedule for January 16, 2006 to January 15, 2007. This Payment Schedule shows that Berman ("SB") had $548,289,502.82 under management and was designated $1,314,973.75 after adjustments. Compl. Ex. 4.

The Cohmad Representatives' arguments that they accepted their Commissions in good faith and in exchange for value may be raised as affirmative defenses at summary judgment or trial with respect to these Subsequent Transfers of Commissions under sections 550(b)(1) of the Code and 278(2) of the NYDCL. *See Goldman v. Capital City Mortgage Corp. (In Re Nieves),* No. 08–2160, 2011 WL 2279423, at *4 (4th Cir. June 10, 2011) ("[O]nce the plaintiff has established that a party is an immediate or mediate transferee of the initial transferee, a defendant claiming a defense to liability under § 550(b) bears the burden of proof."); *Mendelsohn v. Jacobowitz (In re Jacobs),* 394 B.R. 646, 659 (Bankr.E.D.N.Y.2008) ("An innocent purchaser must affirmatively show good faith in order to take advantage of [NYDCL] section 278(2)."); *In re M. Fabrikant & Sons, Inc.,* 394 B.R. at 740 n. 20 ("[Section 550(b)(1) of the Code] are affirmative defenses that the transferee defendant must plead and prove.").

For these reasons, the Trustee has sufficiently pled Count Nine of the Complaint to recover Subsequent Transfers of Commissions pursuant to section 550(a)(2) of the Code and section 278 of the NYDCL.

VI. THE TRUSTEE HAS SUFFICIENTLY PLED A BASIS FOR DISALLOWING THE MOVING DEFENDANTS' SIPA CLAIMS

[18] The Trustee has sufficiently pled Count Ten of the Complaint to disallow the Defendants' SIPA claims as not supported by BLMIS books and records, as well as under section 502(d) of the Code. The Trustee adequately alleges that the BLMIS books and records indicate that the transfers to the Moving Defendants, detailed in Exhibit 17 to the Complaint, included Fictitious Profits above the amount of principal invested, precluding the Moving Defendants from receiving SIPC advances and distributions from the pool of assets collected by the Trustee. Compl. ¶¶ 138, 198; *see also In re BLMIS,* 424 B.R. at 125 (defining net equity by reference to amounts invested less amounts withdrawn). In addition, the Moving Defendants are sufficiently alleged ***342** to be transferees of property "recoverable under section ... 550, ... 544, ... [or] 548" of the Code, express grounds for disallowance under section 502(d) of the Code. 11 U.S.C. § 502(d). Accordingly, the Motions to Dismiss Count Ten of the Complaint are denied.[FN22]

> FN22. Marilyn Cohn asserts that she has not filed a SIPA claim, and the Trustee does not dispute this assertion. Rather, the Trustee acknowledges that "Count Ten applies only to those claims that were filed." Plaintiff's Memorandum of Law in Opposition to Defendants' Motions to Dismiss at p. 69. Dkt. No. 135.

VII. THE TENANCY DEFENDANTS' MOTION TO DISMISS FOR LACK OF PERSONAL JURISDICTION WAS PREVIOUSLY DENIED BY THIS COURT AND IS PROCEDURALLY AND SUBSTANTIVELY DEFICIENT

In their Motion to Dismiss, the Tenancy Defendants misguidedly seek to relitigate personal jurisdiction arguments that this Court previously considered, upon full briefing and oral argument, and denied by written decision dated October 26, 2009 (the "October 26, 2009 Decision"). *Picard v. Cohmad Sec. Corp., (In re BLMIS),* 418 B.R. 75, 79–82 (Bankr.S.D.N.Y.2009). There, this Court found, *inter alia,* that the claims asserted by the Trustee arose out of the Tenancy Defendants' "extensive profitable contacts with the forum," including transactions they directed to and from their New York BLMIS bank accounts "for many years with regular success." *Id.* at 81. This ruling was not appealed.

[19][20] With no change in the factual circumstances upon which this Court based its October 26, 2009 Decision, and no proper motion for reargument having been presented, the Court finds no reason to depart from its prior finding of personal jurisdiction. Indeed, the rule authorizing motions for reargument "is strictly construed to avoid repetitive arguments on issues that the court has already fully considered." *Family Golf Ctrs., Inc. v. Acushnet Co. (In re Randall's Island Family Golf Ctrs., Inc.),* 290 B.R. 55, 61 (Bankr.S.D.N.Y.2003). Such a motion is not, as attempted here, "a vehicle for relitigating old issues, presenting the case under new theories, securing a rehearing on the merits, or otherwise taking a second bite at the apple." *Sequa Corp. v. GBJ Corp.,* 156

F.3d 136, 144 (2d Cir.1998) (internal quotations and citations omitted).

Under the circumstances, the Tenancy Defendants' resurrection is a procedurally improper attempt to relitigate the Complaint's purported "continuing failure" to allege personal jurisdiction. *See* Dkt. No. 127. This Court finds no plausible explanation for the reargument other than to cause "unnecessary delay" in getting to the merits of the Trustee's claims, causing a "needless increase in the cost of litigation." FED. R. BANKR.P. 9011(b)(1); *see also* 28 U.S.C. § 1927. Accordingly, while the Court, in its discretion, declines to impose sanctions at the present time, the Tenancy Defendants' Motion to Dismiss for lack of personal jurisdiction is, once again, denied.

CONCLUSION

Accepting as true the facts pled in the Complaint and drawing all inferences that may be warranted by such facts, the Trustee has pled valid *prima facie* claims against the Moving Defendants, and the Motions to Dismiss under Rule 12(b)(6) are therefore DENIED to the extent set forth herein.

IT IS SO ORDERED.

Bkrtcy.S.D.N.Y.,2011.
In re Bernard L. Madoff Inv. Securities LLC
454 B.R. 317, 55 Bankr.Ct.Dec. 81

END OF DOCUMENT

EXHIBIT 10

458 B.R. 87, 55 Bankr.Ct.Dec. 139
(Cite as: 458 B.R. 87)

H

United States Bankruptcy Court,
S.D. New York.
In re BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Debtor.
Irving H. Picard, as Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff,
v.
Peter B. Madoff, Mark D. Madoff, Andrew H. Madoff, and Shana D. Madoff, Defendants.

Bankruptcy No. 08–01789 (BRL).
Adversary No. 09–1503 (BRL).
Sept. 22, 2011.

Background: Trustee for substantively consolidated liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal brought adversary proceeding against principal's brother, two sons, and niece, asserting claims to avoid and recover alleged preferential and fraudulent transfers under Bankruptcy Code and New York law, claims to disallow and equitably subordinate defendants' claims filed in SIPA proceeding, and common-law tort claims for breach of fiduciary duty, negligence, conversion, unjust enrichment, constructive trust, and accounting. Defendants moved to dismiss.

Holdings: The Bankruptcy Court, Burton R. Lifland, J., held that:
(1) complaint adequately alleged that transfers of bonuses and salaries were made for less than reasonably equivalent value or fair equivalent value, as required to state claims for constructive fraudulent transfer;
(2) safe harbor provision did not provide basis for dismissing constructive fraudulent transfer claims stemming from defendants' withdrawals of alleged fictitious profits from investment advisory accounts;
(3) complaint did not sufficiently plead preferential transfers claims;
(4) trustee did not sufficiently plead claims to recover subsequent transfers;
(5) trustee adequately pleaded claim for disallowance of defendants' SIPA claims;
(6) trustee adequately pleaded claim for equitable subordination; and
(7) New York's Martin Act did not preempt common-law claims.

Motion granted in part and denied in part.

West Headnotes

[1] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Claim brought under Bankruptcy Code's actual fraudulent transfer provision or New York's actual fraudulent transfer statute must be supported by enough factual allegations to satisfy the pleading requirements set forth under fraud pleading rule. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[2] Bankruptcy 51 ⚿2726(4)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726 Presumptions
51k2726(4) k. Fraudulent transfers. Most Cited Cases

Presumption of actual intent to defraud arising from Ponzi scheme, on grounds that transfers made in course of Ponzi scheme could have been made for no purpose other than to hinder, delay, or defraud creditors, establishes debtors' fraudulent intent required for actual fraudulent transfer claims under both Bankruptcy Code and New York actual fraudulent transfer statute. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules

Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[3] Bankruptcy 51 ⚿2726(4)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726 Presumptions
51k2726(4) k. Fraudulent transfers. Most Cited Cases

Ponzi scheme presumption applied to establish actual fraudulent intent element, as to transferors, of fraudulent transfer claims asserted under Bankruptcy Code and New York law, given breadth and notoriety of Ponzi scheme and principal's criminal admission, and given that challenged transfers, which included redemptions of fictitious profits and payments of salaries, served to further Ponzi scheme. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[4] Bankruptcy 51 ⚿2726(4)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726 Presumptions
51k2726(4) k. Fraudulent transfers. Most Cited Cases

Ponzi scheme presumption that transfers made in course of Ponzi scheme were made with actual intent to hinder, delay, or defraud creditors applies only to transferor's intent. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[5] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

For trustee to state claim for actual fraudulent transfer under either Bankruptcy Code or New York law, complaint need not negate transferee's good faith. 11 U.S.C.A. § 548(a)(1)(A), (c); N.Y.McKinney's Debtor and Creditor Law §§ 276, 278.

[6] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Defendants' good faith affirmative defense did not appear on the face of complaint asserting actual fraudulent transfer claims under Bankruptcy Code and New York law, given allegations that defendants had notice of fraud and were cognizant of irregularities in their own investment advisory accounts with transferor-investment company, and therefore good faith was not viable ground for dismissal for failure to state claim upon which relief could be granted. 11 U.S.C.A. § 548(a)(1)(A), (c); Fed.Rules Bankr.Proc.Rule 7012, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law §§ 276, 278.

[7] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

For complaint to state prima facie claim for actual fraudulent transfer under Bankruptcy Code or New York law, transfers sought to be avoided must be identified with particularity required by fraud pleading rule. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

458 B.R. 87, 55 Bankr.Ct.Dec. 139
(Cite as: 458 B.R. 87)

[8] Securities Regulation 349B ⚷185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal failed to satisfy fraud pleading rule in identifying transfers that were subject of actual fraudulent transfer claims asserted under Bankruptcy Code and New York law, even under more relaxed standards applied to claims raised by bankruptcy trustee, where trustee did not specify which count of complaint he sought to employ to avoid each challenged transfer, trustee did not indicate how he arrived at total sum that he sought to avoid under each count, total number of transfers that were included in each sum, or which statutory lookback period upon which he intended to rely, and majority of challenged transfers were not identified completely. 11 U.S.C.A. § 548(a)(1)(A); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[9] Bankruptcy 51 ⚷2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

To satisfy fraud pleading rule's particularity requirement, party asserting actual fraudulent transfer claim must ordinarily allege (1) the property subject to the transfer, (2) the timing and, if applicable, frequency of the transfer, and (3) the consideration paid with respect thereto. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[10] Bankruptcy 51 ⚷2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Even under relaxed standard for allegations of fraud applied where actual fraudulent transfer is asserted by bankruptcy trustee, pleadings still must be particular enough to fulfill purpose of fraud pleading rule: to protect the defending party's reputation, to discourage meritless accusations, and to provide detailed notice of fraud claims to defending parties. Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[11] Bankruptcy 51 ⚷2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Complaint sufficiently identified, pursuant to fraud pleading rule, transfers sought to avoided and recovered as actual fraudulent transfers under Bankruptcy Code and New York law where complaint alleged transferee, transferor, and specific transfer dates and amounts. 11 U.S.C.A. § 548(a)(1)(A); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 276.

[12] Federal Courts 170B ⚷13

170B Federal Courts
170BI Jurisdiction and Powers in General
170BI(A) In General
170Bk12 Case or Controversy Requirement
170Bk13 k. Particular cases or questions, justiciable controversy. Most Cited Cases

Claim for award of attorney fees pursuant to New York's fraudulent transfer statutes was not ripe for determination at motion-to-dismiss stage of adversary proceeding asserting actual fraudulent transfer claims. N.Y.McKinney's Debtor and Creditor Law §§ 276, 276–a.

[13] Securities Regulation 349B ⚷185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Pursuant to Bankruptcy Code's strong-arm statute, trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal had standing to invoke New York's discovery rule to make timely state-law actual fraudulent transfer claims based on transfers that occurred more than six years before SIPA liquidation's filing date where trustee alleged that, at all times relevant to transfers, fraudulent scheme perpetrated by company was not reasonably discoverable by at least one of company's unsecured creditors and one or more creditors had and continued to hold allowable matured or unmatured unsecured claims against company, which provided sufficient notice to defendants of at least one category of creditors on whose claims trustee relied. 11 U.S.C.A. § 544(b); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; N.Y.McKinney's Debtor and Creditor Law § 276; N.Y.McKinney's CPLR 203(g), 213(8).

[14] Bankruptcy 51 ⚿2704

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2704 k. Trustee as representative of debtor or creditors. Most Cited Cases

So long as trustee provides sufficient notice to defendants of at least one category of creditors that have standing to avoid an actual fraudulent transfer under non-bankruptcy law, trustee has standing to assert that actual fraudulent transfer claim under Bankruptcy Code's strong-arm statute. 11 U.S.C.A. § 544(b).

[15] Fraudulent Conveyances 186 ⚿77

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(G) Consideration
186k77 k. Sufficiency in general. Most Cited Cases

Fraudulent Conveyances 186 ⚿155

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(L) Knowledge and Intent of Grantee
186k155 k. Elements of fraud in general. Most Cited Cases

Lack of fair consideration can be established under New York's constructive fraudulent transfer laws by showing either a lack of fair equivalent property or a lack of good faith on the part of the transferee. N.Y.McKinney's Debtor and Creditor Law §§ 272, 273, 274, 275.

[16] Bankruptcy 51 ⚿2643

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2643 k. Insolvency of debtor. Most Cited Cases

Fraudulent Conveyances 186 ⚿57(1)

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(E) Insolvency of Grantor
186k56 Solvency of Grantor
186k57 In General
186k57(1) k. In general. Most Cited Cases

By virtue of its engagement in Ponzi scheme, investment company was insolvent at relevant times for purposes of alleged constructive fraudulent transfers challenged under Bankruptcy Code and New York law. 11 U.S.C.A. §§ 544, 548(a)(1)(B); N.Y.McKinney's Debtor and Creditor Law §§ 273, 274, 275.

[17] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings

51k2724 k. Pleading. Most Cited Cases

Plaintiff asserting constructive fraudulent transfer claim under either Bankruptcy Code or New York law need only satisfy general fraud pleading rule, rather than heightened standards of fraud pleading rule, by providing short and plain statement of claim showing entitlement to relief. 11 U.S.C.A. §§ 544, 548(a)(1)(B); N.Y.McKinney's Debtor and Creditor Law §§ 273, 274, 275; Fed.Rules Bankr.Proc.Rules 7008, 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rules 8(a)(2), 9(b), 28 U.S.C.A.

[18] Bankruptcy 51 ⚿2162

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2162 k. Pleading; dismissal. Most Cited Cases

Purpose of general pleading requirement is to ensure that defendant receives fair notice of what the claim is and the grounds upon which it rests. Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a)(2), 28 U.S.C.A.

[19] Bankruptcy 51 ⚿2162

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2162 k. Pleading; dismissal. Most Cited Cases

Sole consideration in evaluating pleadings under general pleading rule is whether, consistent with the requirements of the rule, complaint gives defendant sufficient notice to prepare an answer, frame discovery, and defend against the charges. Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a)(2), 28 U.S.C.A.

[20] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Claims for constructive fraudulent transfer which were based on allegations that defendants, who worked for investment company involved in Ponzi scheme, had breached their fiduciary duties by failing to perform their compliance responsibilities, and thus did not provide value for their wages, did not sound in fraud and did not have to satisfy fraud pleading rule. 11 U.S.C.A. §§ 544, 548(a)(1)(B); N.Y.McKinney's Debtor and Creditor Law §§ 273, 274, 275; Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[21] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

In asserting claims for constructive fraudulent transfer under Bankruptcy Code and New York law, complaint adequately alleged that loans purportedly extended to defendants, who were executives of investment company that engaged in Ponzi scheme, were made for less than reasonably equivalent value or fair equivalent value where complaint alleged that promissory notes given in exchange for loans were executed pro forma without intent to repay and that no payment of principal, interest, or otherwise had been made since loans occurred. 11 U.S.C.A. §§ 544, 548(a)(1)(B); N.Y.McKinney's Debtor and Creditor Law §§ 273, 274, 275.

[22] Bankruptcy 51 ⚿2726(4)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726 Presumptions
51k2726(4) k. Fraudulent transfers. Most Cited Cases

Fictitious profits from a Ponzi scheme are deemed to have been received for less than reasonably equivalent value, as required to avoid such transfers as constructive fraudulent transfers under Bank-

ruptcy Code. 11 U.S.C.A. § 548(a)(1)(B).

[23] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

By alleging that executives for investment company that engaged in Ponzi scheme breached their fiduciary duties to company and thus did not provide services which might otherwise have constituted adequate consideration in exchange for executives' receipt of salaries and bonuses, complaint adequately alleged that transfers of bonuses and salaries were made for less than reasonably equivalent value, as required to state claims for constructive fraudulent transfer under Bankruptcy Code, or without fair equivalent value, as required to state claim under New York law. 11 U.S.C.A. § 548(a)(1)(B); N.Y.McKinney's Debtor and Creditor Law §§ 273, 274, 275.

[24] Bankruptcy 51 ⚿2162

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2162 k. Pleading; dismissal. Most Cited Cases

In accordance with the liberal pleading requirements of general pleading rule, plaintiff need not provide specific facts to support its allegations. Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.

[25] Bankruptcy 51 ⚿2162

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2162 k. Pleading; dismissal. Most Cited Cases

General pleading rule does not require that complaint be a model of clarity or exhaustively present the facts alleged, as long as it gives each defendant fair notice of what plaintiff's claim is and the facts upon which it rests. Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.

[26] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Under general pleading rule, allegations that $6,645,000 was transferred from investment company to attorney of company's executive in two consecutive months of particular year for purchase of home provided sufficient information to apprise defendants of claim that transfers were constructively fraudulent transfers under Bankruptcy Code and New York law. 11 U.S.C.A. §§ 544, 548(a)(1)(B); Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law §§ 273, 274, 275.

[27] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Under general pleading rule, complaint asserting constructive fraudulent transfer claims against executives for investment company that engaged in Ponzi scheme adequately alleged challenged transfers, such as withdrawals from investment advisory accounts and use of company's credit cards to pay personal expenses, even though complaint aggregated transfers over six-year period and thus failed to identify transfers sought to be avoided under Bankruptcy Code and those sought to be avoided under New York law; executives had notice of allegations that they provided insufficient value for transfers at a time when company was insolvent. 11 U.S.C.A. §§ 544, 548(a)(1)(B); Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law §§ 273, 274, 275.

[28] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Complaint failed to adequately plead, under general pleading rule, claims for constructive fraudulent transfer under Bankruptcy Code and New York law as to aggregated transfers that extended beyond any applicable lookback period and transfers that were listed without associated dates, since court could not determine whether such claims fell within any applicable lookback period. 11 U.S.C.A. §§ 544, 548(a)(1)(B); Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law §§ 273, 274, 275.

[29] Limitation of Actions 241 ⚿100(3)

241 Limitation of Actions
241II Computation of Period of Limitation
241II(F) Ignorance, Mistake, Trust, Fraud, and Concealment or Discovery of Cause of Action
241k98 Fraud as Ground for Relief
241k100 Discovery of Fraud
241k100(3) k. Fraud in obtaining possession of or title to property. Most Cited Cases

New York discovery rule is not available to allow plaintiff to avoid constructive fraudulent transfers occurring more than six years before filing of complaint. N.Y.McKinney's Debtor and Creditor Law §§ 273, 274, 275; N.Y.McKinney's CPLR 203(g), 213(8).

[30] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Bankruptcy Code's safe harbor provision, barring avoidance of settlement payment made by or to, or for benefit of, stockbroker in connection with securities contract, provided affirmative defense that was not clearly established on face of complaint in action by trustee in liquidation of investment company and its principal under Securities Investor Protection Act (SIPA) asserting constructive fraudulent transfer claims against company's executives based on alleged withdrawals of fictitious profits from Ponzi scheme, given questions regarding whether principal was "stockbroker," whether payments were "settlement payments," and whether "securities contract" ever existed, and application of safe harbor to transfers occurring in Ponzi scheme was also contrary to purposes of safe harbor and incompatible with SIPA, and therefore safe harbor did not provide basis for dismissing claims. 11 U.S.C.A. §§ 101(53A)(A, B), 546(e), 548(a)(1)(B), 741(7)(A)(i–xi), (8); Securities Investor Protection Act of 1970, §§ 6(b), 8(c)(3), 15 U.S.C.A. §§ 78fff(b), 78fff–2(c)(3).

[31] Bankruptcy 51 ⚿2701

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2701 k. Avoidance rights and limits thereon, in general. Most Cited Cases

Settlement payments subject to Bankruptcy Code's safe harbor barring trustee's avoidance of settlement payment made by or to, or for benefit of, stockbroker in connection with securities contract must be made in the context of a securities transaction. 11 U.S.C.A. § 546(e).

[32] Bankruptcy 51 ⚿2701

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2701 k. Avoidance rights and limits thereon, in general. Most Cited Cases

Bankruptcy Code's safe harbor barring trustee's avoidance of settlement payment made by or to, or for benefit of, stockbroker in connection with securities contract is intended to promote stability and instill investor confidence in the commodities and secu-

rities markets. 11 U.S.C.A. § 546(e).

[33] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

Claims to avoid and recover preferential payments are not held to the heightened pleading requirements of fraud pleading rule. 11 U.S.C.A. § 547(b); Fed.Rules Bankr.Proc.Rule 7009, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[34] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal adequately pleaded that defendants to which alleged preferential transfers were made were company's "insiders," triggering one-year preference lookback period, where defendants were all close relatives of company's principal and were officers or senior managers at company. 11 U.S.C.A. §§ 101(31)(B), 547(b); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a)(2), 28 U.S.C.A.

[35] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Ponzi scheme in which investment company engaged was presumptively insolvent, and therefore trustee in liquidation, under Securities Investor Protection Act (SIPA), of company and its principal was not required to allege specific facts supporting company's insolvency at times of challenged transfers in asserting preferential transfer claims against company's insiders. 11 U.S.C.A. § 547(b); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

[36] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Allegations that challenged payments were compensation for services performed prior to when payment was made adequately pleaded element of preferential transfer claim requiring that payment be made to creditor on account of antecedent debt in action by trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal against company's officers and senior managers. 11 U.S.C.A. § 547(b); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

[37] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal did not sufficiently plead preferential transfers claims asserted against company's officers and senior managers where allegations aggregated challenged transfers into lump sum, without specifying such information as number of preferences, amount of any specific preference, or identity of person who received specific preferences, which did not provide enough notice for officers and senior managers to prepare answer or affirmative defenses, such as whether transfer was made in ordinary course of business or whether there was contemporaneous ex-

change for new value. 11 U.S.C.A. § 547(b, c); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.

[38] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal did not sufficiently plead claims under Bankruptcy Code and New York law to recover fraudulent transfers subsequently transferred to defendants, who were family members of principal and insiders of company, where trustee merely pleaded, on information and belief, that subsequent transfers were made, either directly or indirectly, without providing any sort of estimate of amount of purported subsequent transfers or information as to when or how transfers occurred, leaving defendants without notice as to which subsequent transfers were sought to be recovered. 11 U.S.C.A. § 550(a)(2); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.; N.Y.McKinney's Debtor and Creditor Law § 278.

[39] Bankruptcy 51 ⚿2724

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2724 k. Pleading. Most Cited Cases

In determining whether a claim to recover fraudulent transfers from a subsequent transferee is adequately pled, general pleading rule governs. 11 U.S.C.A. § 550(a)(2); Fed.Rules Bankr.Proc.Rule 7008, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 8(a), 28 U.S.C.A.

[40] Securities Regulation 349B ⚿185.17

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.17 k. Claims of broker-dealers and other noncustomers. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal adequately pleaded claim for disallowance of SIPA claims of company officers and senior managers by alleging that officers and senior managers were recipients of transfers of company's property that were recoverable under Bankruptcy Code and SIPA and that transfers had not been returned to trustee. 11 U.S.C.A. § 502(d); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

[41] Bankruptcy 51 ⚿2824

51 Bankruptcy
51VII Claims
51VII(A) In General
51k2822 Creditors Entitled to Assert Claims
51k2824 k. Effect of avoidable transfer and surrender thereof. Most Cited Cases

Purpose of bankruptcy statute permitting disallowance of any claim of any entity that is a transferee of a voidable transfer is to preclude entities that have received voidable transfers from sharing in the distribution of assets unless and until the voidable transfer has been returned to the estate. 11 U.S.C.A. § 502(d).

[42] Securities Regulation 349B ⚿185.17

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.17 k. Claims of broker-dealers and other noncustomers. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal adequately pleaded claim to equitably subordinate SIPA claims of company officers and senior managers who were principal's family mem-

bers where complaint alleged that officers and senior managers breached their fiduciary duties to company, directly harming it, and that officers and senior managers were unjustly enriched at company's expense due to their failures to adequately perform their fiduciary duties. 11 U.S.C.A. § 510(c); Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

[43] Bankruptcy 51 ⚿2972

51 Bankruptcy
51VII Claims
51VII(F) Priorities
51k2972 k. Determination of priority. Most Cited Cases

To plead equitable subordination successfully, complaint must contain enough facts to satisfy each part of the following three-part test: (1) that defendant-claimant engaged in inequitable conduct, (2) that the misconduct caused injury to the creditors or conferred an unfair advantage on defendant-claimant, and (3) that bestowing the remedy of equitable subordination is not inconsistent with bankruptcy law. 11 U.S.C.A. § 510(c).

[44] Bankruptcy 51 ⚿2967.5

51 Bankruptcy
51VII Claims
51VII(F) Priorities
51k2967 Subordination
51k2967.5 k. Inequitable conduct. Most Cited Cases

Under Bankruptcy Code, equitable subordination is confined to offsetting specific harm that creditors have suffered on account of the inequitable conduct, and is remedial, not penal. 11 U.S.C.A. § 510(c).

[45] Securities Regulation 349B ⚿185.14

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.13 Powers and Duties of Trustee
349Bk185.14 k. In general; collection of assets. Most Cited Cases

Given the "hybrid" nature of a liquidation under Securities Investor Protection Act (SIPA), SIPA trustee has at least as many powers and responsibilities as an ordinary bankruptcy trustee under Bankruptcy Code. Securities Investor Protection Act of 1970, § 7(a), 15 U.S.C.A. § 78fff–1(a).

[46] Bankruptcy 51 ⚿2154.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2154 Rights of Action by or on Behalf of Trustee or Debtor
51k2154.1 k. In general; standing. Most Cited Cases

Bankruptcy trustee has standing to assert claims against corporate insiders alleging injury to debtor.

[47] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal had standing to assert common-law claims against company's officers, directors, and managers to the extent that claims belonged to company's estate. Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

[48] Bankruptcy 51 ⚿2154.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2154 Rights of Action by or on Behalf of Trustee or Debtor
51k2154.1 k. In general; standing. Most Cited Cases

"*Wagoner* rule" deprives trustee of standing to bring in federal court a common law claim that is

clearly defeated by the doctrine of in pari delicto barring wrongdoer's recovery against commensurate wrongdoer.

[49] Action 13 ⚿4

13 Action
13I Grounds and Conditions Precedent
13k4 k. Illegal or immoral transactions. Most Cited Cases

Under New York law, the doctrine of "in pari delicto" operates as an affirmative defense whereby a wrongdoer, or a plaintiff asserting a claim on behalf of a wrongdoer, is generally barred from recovering against a commensurate wrongdoer.

[50] Corporations and Business Organizations 101 ⚿2374(1)

101 Corporations and Business Organizations
101IX Corporate Powers and Liabilities
101IX(B) Representation of Corporation by Corporate Principals
101k2368 Wrongful Acts or Omissions
101k2374 Adverse Interest
101k2374(1) k. In general. Most Cited Cases

Under "*Wagoner* rule," a claim against a third party for defrauding a corporation accrues to creditors, not to the guilty corporation.

[51] Corporations and Business Organizations 101 ⚿2374(1)

101 Corporations and Business Organizations
101IX Corporate Powers and Liabilities
101IX(B) Representation of Corporation by Corporate Principals
101k2368 Wrongful Acts or Omissions
101k2374 Adverse Interest
101k2374(1) k. In general. Most Cited Cases

Wagoner rule, providing that claim against third party for defrauding corporation accrues to creditors, not the guilty corporation, and in pari delicto rule, barring wrongdoer's recovery against commensurate wrongdoer, do not apply to actions of fiduciaries who are corporation's insiders in the sense that they either are on the board or in management, or in some other way control the corporation.

[52] Corporations and Business Organizations 101 ⚿2303

101 Corporations and Business Organizations
101IX Corporate Powers and Liabilities
101IX(B) Representation of Corporation by Corporate Principals
101k2301 Application of Principle of Agency to Corporations
101k2303 k. Corporation acts through officers or agents. Most Cited Cases

Corporations and Business Organizations 101 ⚿2585(1)

101 Corporations and Business Organizations
101IX Corporate Powers and Liabilities
101IX(F) Civil Actions
101k2583 Evidence as to Authority of Corporate Principals
101k2585 Presumptions
101k2585(1) k. In general. Most Cited Cases

Under New York law, corporation is represented by its officers and agents, and all of their corporate acts, including fraudulent ones, are subject to the presumption of imputation to the corporation.

[53] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal sufficiently alleged that positions of defendants, who were senior officers, directors, and compliance managers at company, rendered them insiders and fiduciaries, and thus was not barred from asserting common-law claims against them on company's behalf by *Wagoner* rule, which provided that

claim against third party for defrauding corporation accrued to creditors, not guilty corporation, or doctrine of in pari delicto, barring wrongdoer's recovery against commensurate wrongdoer. Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

[54] Corporations and Business Organizations 101 ⚿2369

101 Corporations and Business Organizations
101IX Corporate Powers and Liabilities
101IX(B) Representation of Corporation by Corporate Principals
101k2368 Wrongful Acts or Omissions
101k2369 k. In general. Most Cited Cases

General partners, sole shareholders, and sole decision makers are "insiders" or "fiduciaries" of corporation for purposes of in pari delicto doctrine under New York common law.

[55] Corporations and Business Organizations 101 ⚿2369

101 Corporations and Business Organizations
101IX Corporate Powers and Liabilities
101IX(B) Representation of Corporation by Corporate Principals
101k2368 Wrongful Acts or Omissions
101k2369 k. In general. Most Cited Cases

Under New York law, even a third-party professional, typically the quintessential outsider, may surrender an in pari delicto defense to claim where it exerts sufficient domination and control over guilty corporation to render itself an insider.

[56] Corporations and Business Organizations 101 ⚿1841

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(D) Rights, Duties, and Liabilities as to Corporation and Its Shareholders or Members
101k1840 Fiduciary Duties as to Management of Corporate Affairs in General
101k1841 k. In general. Most Cited Cases

Implied and Constructive Contracts 205H ⚿3

205H Implied and Constructive Contracts
205HI Nature and Grounds of Obligation
205HI(A) In General
205Hk2 Constructive or Quasi Contracts
205Hk3 k. Unjust enrichment. Most Cited Cases

Trusts 390 ⚿102(1)

390 Trusts
390I Creation, Existence, and Validity
390I(C) Constructive Trusts
390k102 Breach of Duty by Person in Fiduciary Relation in General
390k102(1) k. In general. Most Cited Cases

Common-law claims for breach of fiduciary duty, negligence, conversion, unjust enrichment, constructive trust, and accounting asserted by trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal against company's insiders and fiduciaries were not based on fraud, deception, unreasonable future promise, or false representation, but instead relied upon allegations that defendants failed to carry out their compliance and supervisory responsibilities and improperly used company funds for personal use, and therefore New York's Martin Act, which authorized State Attorney General to pursue claims arising out of securities fraud, did not apply to preempt claims. Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.; N.Y.McKinney's General Business Law § 352–c.

[57] Fraud 184 ⚿7

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k5 Elements of Constructive Fraud
184k7 k. Fiduciary or confidential relations. Most Cited Cases

Under New York law, elements of a cause of action to recover damages for breach of fiduciary duty are (1) the existence of a fiduciary relationship, (2)

misconduct by the defendant, and (3) damages directly caused by the defendant's misconduct.

[58] Negligence 272 ⚿202

272 Negligence
272I In General
272k202 k. Elements in general. Most Cited Cases

Elements of a claim for negligence under New York law are (1) a duty owed to the plaintiff by the defendants, (2) breach of that duty, and (3) injury substantially caused by that breach.

[59] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal adequately alleged existence of fiduciary relationship between company and individuals who served as company's chief compliance officer, senior managers and co-directors of trading, and compliance director and in-house counsel in support of claim, under New York law, for breach of fiduciary duty, given allegations that each relationship was characterized by trust and reliance and an assumption of control and responsibility for company's affairs. Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

[60] Securities Regulation 349B ⚿185.21

349B Securities Regulation
349BI Federal Regulation
349BI(F) Liquidation of Broker–Dealers; Securities Investor Protection Corporation
349Bk185.21 k. Proceedings. Most Cited Cases

Trustee in liquidation, under Securities Investor Protection Act (SIPA), of investment company and its principal plausibly alleged, as element of claims under New York law for breach of fiduciary duty and negligence, that conduct of company's chief compliance officer (CCO), senior managers, and compliance director, whether intentional or negligent, breached their duties to properly supervise company's operations; trustee alleged that CCO and compliance director failed to monitor compliance with federal securities laws and regulations, that senior managers were, as licensed options principals, responsible for monitoring and approving company's options and transactions, and that all defendants, in violation of company's anti-money laundering compliance program, did not investigate or detect suspicious transfers by company to foreign affiliate for which three defendants were directors. Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

[61] Corporations and Business Organizations 101 ⚿1841

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(D) Rights, Duties, and Liabilities as to Corporation and Its Shareholders or Members
101k1840 Fiduciary Duties as to Management of Corporate Affairs in General
101k1841 k. In general. Most Cited Cases

Under New York law, fiduciary duties include discharging corporate responsibilities in good faith and with conscientious fairness, morality, and honesty in purpose and displaying good and prudent management of the corporation.

[62] Corporations and Business Organizations 101 ⚿1841

101 Corporations and Business Organizations
101VII Directors, Officers, and Agents
101VII(D) Rights, Duties, and Liabilities as to Corporation and Its Shareholders or Members
101k1840 Fiduciary Duties as to Management of Corporate Affairs in General
101k1841 k. In general. Most Cited Cases

Under New York law, fraudulent activities of investment company's principal, in operating Ponzi scheme, did not serve as supervening cause that severed causal link between alleged breaches of fiduci-

ary duties by company's officers and senior managers and foreseeable harm resulting to company, so as to preclude liability of officers and senior managers for such breaches, since officers and senior managers were best situated and obligated to uncover or prevent principal's fraud, but instead allegedly shirked their duties and engaged in improper personal use of company funds.

[63] Negligence 272 ⚿433

272 Negligence
272XIII Proximate Cause
272k430 Intervening and Superseding Causes
272k433 k. Intentional or criminal acts. Most Cited Cases

Under New York law, when the intervening, intentional act of another is itself the foreseeable harm that shapes the duty imposed, the defendant who fails to guard against such conduct will not be relieved of liability when that act occurs.

[64] Damages 115 ⚿91.5(3)

115 Damages
115V Exemplary Damages
115k91.5 Grounds for Exemplary Damages
115k91.5(3) k. Particular cases in general. Most Cited Cases

Fraud 184 ⚿61

184 Fraud
184II Actions
184II(E) Damages
184k61 k. Exemplary. Most Cited Cases

Complaint stated claim for award of punitive damages, on claims for negligence and breach of fiduciary duty against officers and senior managers of investment company involved in Ponzi scheme, by alleging that officers and senior managers failed to provide meaningful supervision of company and ignored numerous red flags and irregularities to enrich themselves and their outside business ventures at company's expense.

[65] Damages 115 ⚿87(1)

115 Damages
115V Exemplary Damages
115k87 Nature and Theory of Damages Additional to Compensation
115k87(1) k. In general. Most Cited Cases

Under New York law, punitive damages serve the dual purposes of punishing the offending party while deterring similar conduct by others.

[66] Damages 115 ⚿91.5(1)

115 Damages
115V Exemplary Damages
115k91.5 Grounds for Exemplary Damages
115k91.5(1) k. In general. Most Cited Cases

To be liable for punitive damages in tort causes of action under New York law, defendant's actions must constitute willful or wanton negligence or recklessness.

[67] Damages 115 ⚿91.5(1)

115 Damages
115V Exemplary Damages
115k91.5 Grounds for Exemplary Damages
115k91.5(1) k. In general. Most Cited Cases

Acts are "wanton" and "reckless," as required for award of punitive damages under New York law, when done in a manner showing heedlessness and an utter disregard for the rights and safety of others.

[68] Damages 115 ⚿87(1)

115 Damages
115V Exemplary Damages
115k87 Nature and Theory of Damages Additional to Compensation
115k87(1) k. In general. Most Cited Cases

Decision to award punitive damages resides in the sound discretion of the original trier of facts under New York law.

[69] Account 9 ⚿4

9 Account
9I Right of Action and Defenses
9k4 k. Fiduciary relations. Most Cited Cases

Complaint stated claim for accounting under New York law by alleging that officers and senior managers of investment company had fiduciary relationship with company and that they breached those duties to company and diverted its assets for their own benefit, including by using company funds to pay their personal expenses.

[70] Account 9 ⚿1

9 Account
9I Right of Action and Defenses
9k1 k. Nature and grounds of right to an account. Most Cited Cases

Under New York law, an accounting is a cause of action that seeks an adjustment of the accounts of the parties and a rendering of a judgment for the balance ascertained to be due.

[71] Account 9 ⚿4

9 Account
9I Right of Action and Defenses
9k4 k. Fiduciary relations. Most Cited Cases

Account 9 ⚿17(1)

9 Account
9II Proceedings and Relief
9k13 Equitable Actions
9k17 Pleading
9k17(1) k. Bill, complaint, or petition. Most Cited Cases

To state claim for accounting under New York law, it is not necessary to identify a particular asset or fund of money in defendant's possession, but it is necessary to establish the existence of a confidential or fiduciary relationship and a breach of the duty imposed by that relationship respecting property in which the party seeking the accounting has an interest.

[72] Bankruptcy 51 ⚿2154.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2154 Rights of Action by or on Behalf of Trustee or Debtor
51k2154.1 k. In general; standing. Most Cited Cases

Trustee is permitted to pursue an accounting action to determine the extent of self-dealing by debtor-corporation's senior executives and the value of the assets of debtor-corporation.

[73] Implied and Constructive Contracts 205H ⚿3

205H Implied and Constructive Contracts
205HI Nature and Grounds of Obligation
205HI(A) In General
205Hk2 Constructive or Quasi Contracts
205Hk3 k. Unjust enrichment. Most Cited Cases

Allegations that investment company's officers and senior managers misappropriated company's funds for improper personal uses, such as funding personal business ventures and homes, and that officers and senior managers failed to perform legal compliance and supervisory responsibilities which they were legally obligated to perform for company but nevertheless received astronomical compensation from company, stated claim for unjust enrichment under New York law.

[74] Trusts 390 ⚿91

390 Trusts
390I Creation, Existence, and Validity
390I(C) Constructive Trusts
390k91 k. Nature of constructive trust. Most Cited Cases

In determining whether to impose a constructive trust under New York law, courts consider four factors, although those factors are merely useful guides and are not talismanic, including (1) a confidential or fiduciary relationship, (2) a promise, express or implied, (3) a transfer made in reliance on that promise,

and (4) unjust enrichment.

[75] Trusts 390 ⚿91

390 Trusts
390I Creation, Existence, and Validity
390I(C) Constructive Trusts
390k91 k. Nature of constructive trust. Most Cited Cases

Imposition of constructive trust under New York law requires a showing that property is held under circumstances which render unconscionable and inequitable the continued holding of that property, and that the remedy is essential to prevent unjust enrichment.

[76] Implied and Constructive Contracts 205H ⚿3

205H Implied and Constructive Contracts
205HI Nature and Grounds of Obligation
205HI(A) In General
205Hk2 Constructive or Quasi Contracts
205Hk3 k. Unjust enrichment. Most Cited Cases

Unjust enrichment claim brought under New York law must be predicated on factual allegations that defendant was enriched at plaintiff's expense, and that it is against equity and good conscience to permit defendant to retain what is sought to be recovered.

[77] Implied and Constructive Contracts 205H ⚿3

205H Implied and Constructive Contracts
205HI Nature and Grounds of Obligation
205HI(A) In General
205Hk2 Constructive or Quasi Contracts
205Hk3 k. Unjust enrichment. Most Cited Cases

To prove unjust enrichment claim under New York law, it is necessary to show that one party has received money or a benefit at the expense of another; the transaction must be unjust.

[78] Implied and Constructive Contracts 205H ⚿3

205H Implied and Constructive Contracts
205HI Nature and Grounds of Obligation
205HI(A) In General
205Hk2 Constructive or Quasi Contracts
205Hk3 k. Unjust enrichment. Most Cited Cases

Under New York law, whether there is unjust enrichment may not be determined from a limited inquiry confined to an isolated transaction, and, instead, there must be a realistic determination based on a broad view of the human setting involved.

[79] Trusts 390 ⚿371(2)

390 Trusts
390VII Establishment and Enforcement of Trust
390VII(C) Actions
390k371 Pleading
390k371(2) k. Allegations as to creation and existence of trust. Most Cited Cases

Under New York law, complaint which sufficiently alleged that investment company's officers and senior managers were unjustly enriched by property rightfully belonging to company stated claim for imposition of constructive trust.

[80] Bankruptcy 51 ⚿2543

51 Bankruptcy
51V The Estate
51V(C) Property of Estate in General
51V(C)2 Particular Items and Interests
51k2543 k. Property held by debtor as trustee, agent, or bailee. Most Cited Cases

Effect of constructive trust in bankruptcy is to take property out of the debtor's estate.

[81] Conversion and Civil Theft 97C ⚿108

97C Conversion and Civil Theft
97CI Acts Constituting and Liability Therefor
97Ck108 k. Assertion of ownership or control in general. Most Cited Cases

Under New York law, "conversion" is an unauthorized assumption and exercise of the right of ownership over property belonging to another to the exclusion of the owner's rights.

[82] Conversion and Civil Theft 97C 108

97C Conversion and Civil Theft
97CI Acts Constituting and Liability Therefor
97Ck108 k. Assertion of ownership or control in general. Most Cited Cases

Conversion and Civil Theft 97C 124

97C Conversion and Civil Theft
97CII Actions
97CII(A) Right of Action and Defenses
97Ck123 Title and Right to Possession of Plaintiff
97Ck124 k. In general. Most Cited Cases

Under New York law, a conversion action requires plaintiff to have legal ownership or an immediate superior right of possession to the property that he seeks to recover and defendant to exercise unauthorized dominion over that property to the alteration of its condition or to the exclusion of plaintiff's rights.

[83] Conversion and Civil Theft 97C 106

97C Conversion and Civil Theft
97CI Acts Constituting and Liability Therefor
97Ck103 Property Subject of Conversion or Theft
97Ck106 k. Money and commercial paper; debt. Most Cited Cases

When money, rather than a chattel, is the property at issue in action for conversion under New York law, it must be specifically identifiable.

[84] Conversion and Civil Theft 97C 106

97C Conversion and Civil Theft
97CI Acts Constituting and Liability Therefor
97Ck103 Property Subject of Conversion or Theft
97Ck106 k. Money and commercial paper; debt. Most Cited Cases

If allegedly converted money is incapable of being described or identified in the same manner as a specific chattel, it is not the proper subject of a conversion claim under New York law.

[85] Conversion and Civil Theft 97C 106

97C Conversion and Civil Theft
97CI Acts Constituting and Liability Therefor
97Ck103 Property Subject of Conversion or Theft
97Ck106 k. Money and commercial paper; debt. Most Cited Cases

Under New York law, complaint that did not seek a specific amount of money converted from particular account of investment company, but rather sought an award of compensatory damages in amount to be determined at trial, failed to state claim for conversion against company's officers and senior managers.

*99 Baker & Hostetler LLP, By: David J. Sheehan, John Siegal, Marc D. Powers, New York, NY, for Plaintiff, Irving H. Picard, Trustee for the Substantively Consolidated SIPA Liquidation of Bernard L. Madoff Investment Securities LLC and Bernard L. Madoff.

Paul, Weiss, Rifkind, Wharton & Garrison LLP, By: Martin Flumenbaum, Stephen J. Shimshak, Andrew J. Ehrlich, Hannah S. Sholl, New York, NY, for Defendant, Andrew H. Madoff, individually and as Executor of the Estate of Mark D. Madoff.

Lankler Siffert & Wohl LLP, By: Charles T. Spada, New York, NY, for Defendant, Peter B. Madoff.

Smith Valliere PLLC, By: Timothy A. Valliere, New York, NY, for Defendant, Shana D. Madoff.

MEMORANDUM DECISION AND ORDER DENYING IN PART AND GRANTING IN PART DEFENDANTS' MOTIONS TO DISMISS TRUSTEE'S COMPLAINT

BURTON R. LIFLAND, Bankruptcy Judge.

Before this Court are the motions (the "Motions to Dismiss") of Mark D. Madoff [FN1] and Andrew H.

Madoff, Peter M. Madoff, ***100** and Shana D. Madoff (the "Defendants") seeking to dismiss the complaint (the "Complaint") filed in the above-captioned adversary proceeding by Irving H. Picard, Esq. (the "Trustee," or "Plaintiff"), trustee for the substantively consolidated Securities Investor Protection Act ("SIPA") [FN2] liquidation ("SIPA Liquidation") of Bernard L. Madoff Investment Securities LLC ("BLMIS") and Bernard L. Madoff ("Madoff"), pursuant to Federal Rule of Civil Procedure ("Rule") 12(b)(6), made applicable herein by Federal Rule of Bankruptcy Procedure ("Bankruptcy Rule") 7012.[FN3]

FN1. Mark D. Madoff passed away on December 11, 2010. The parties have stipulated that Mark D. Madoff in the above-captioned adversary proceeding is substituted by the Estate of Mark D. Madoff and Andrew H. Madoff, as Executor. *See* Stipulation and Order Substituting Party at p. 2 (dated Apr. 19, 2011) (Dkt. No. 47). For ease of reference, the Estate of Mark D. Madoff and Andrew H. Madoff, Executor, are referred to herein as Mark Madoff or Mark.

FN2. SIPA sections 78fff(b) and 78fff–2(c)(3) allow a SIPA Trustee to utilize the avoidance powers enjoyed by a bankruptcy trustee. *See In re Bernard L. Madoff Inv. Sec. LLC*, 2011 WL 3568936, at *12 n. 10 (*In re BLMIS I*) (2d Cir. Aug. 16, 2011) ("A SIPA liquidation is a hybrid proceeding."). SIPA section 78fff(b) provides that "[t]o the extent consistent with the provisions of this chapter, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of title 11." 15 U.S.C. § 78fff(b). SIPA section 78fff–2(c)(3) states, in relevant part: "whenever customer property is not sufficient to pay in full the claims set forth in subparagraphs (A) through (D) of paragraph (1), the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of Title 11." 15 U.S.C. § 78fff–2(c)(3).

FN3. There is no paucity of decisional law regarding Bernard Madoff and the Trustee's restitutional litigation relating to this Ponzi saga. Instructive and pertinent to the factors to consider when parsing a Rule 12(b) motion to dismiss arising from the Madoff case is the recent decision of U.S. District Judge Kimba Wood (the "District Court") reviewing the Trustee's pleading sufficiency in another Madoff matter set at the same pleading stage as this one. *Picard v. Merkin (In re Bernard L. Madoff Inv. Sec. LLC)*, 11 MC 0012, 2011 WL 3897970, at *13 (S.D.N.Y. Aug.31, 2011) (*Merkin I*).

The instant Complaint differs from all others connected to the Madoff Ponzi scheme in one significant respect: its named Defendants are Madoff's brother, two sons, and niece. As set forth in the Complaint, the Defendants held senior management positions at BLMIS, which, the Trustee asserts, was "operated as if it was the family piggy bank," with the Defendants living in multi-million dollar homes and relying on BLMIS funds to pay for vacations, travel, and other personal expenses—all while failing to fulfill their responsibilities as high ranking employees of the business. This failure was unsurprising given their close familial relationship with Madoff and proximity to BLMIS, both of which undergird the claim at the heart of the Trustee's Complaint: that if anyone was in a position to prevent Madoff's scheme, it was the Defendants, who, instead, stood by profiting mightily while allowing it to persist. The Defendants nevertheless steadfastly contend their involvement with BLMIS was entirely legitimate, and they, above all others, were betrayed by their family's patriarch. But even if they were victims of the cruelest betrayal, the Complaint alleges that the Defendants' failures to fulfill their responsibilities at BLMIS facilitated egregious harms.

The Trustee accordingly seeks to avoid and recover transfers made to the Defendants in the collective amount of over $198 million under various sections of the Bankruptcy Code (the "Code") and New York Debtor and Creditor Law [FN4] (the "NYDCL"); as well as to utilize sections of the Code to disallow and equitably subordinate those claims filed by the Defendants in the SIPA proceeding (collectively, ***101** the "Bankruptcy Claims").[FN5] In addition, the Trustee seeks tort damages for BLMIS by bringing claims under New York common law for breach of

fiduciary duty, negligence, conversion, unjust enrichment, constructive trust, and accounting (the "Common Law Claims"). The Complaint, however, contains some correctable pleading deficiencies, and will need to be amended in part in order to stand as a matter of law.[FN6] Thus, as set forth below, the Defendants' Motions to Dismiss are DENIED in part and GRANTED in part.

FN4. N.Y. Debt. & Cred. Law § 270 *et seq.* (McKinney 2001).

FN5. In accordance with this Court's decision in *Picard v. Merkin* the Trustee withdrew the claim for immediate turnover of alleged customer property pursuant to section 542 of the Code. 440 B.R. 243, 249–51 (Bankr.S.D.N.Y.2010) (*Merkin I*) (dismissing the Trustee's turnover claim); *see also* Letter to Judge Burton R. Lifland in response to the Court's August 4, 2011 request for a supplemental brief addressing the decision in *Picard v. HSBC Bank PLC,* No. 11–CV–0763, *et al.* (S.D.N.Y. July 28, 2011) at p. 2, n. 1 (No. 09–01503) (dated Aug. 12, 2011) (Dkt. No. 50) [Hereinafter "Trustee's Supplemental Letter"].

FN6. The Complaint, like in a game of horseshoes, is a leaner rather than a ringer in that it misses the target, but comes close enough to score. For further discussion on leaners and ringers, see http:// www. horseshoe pitching. com/ rules/ Content. html (last visited on Sept. 21, 2011).

BACKGROUND

A comprehensive discussion of the facts underlying the SIPA Liquidation and Madoff's Ponzi scheme is set forth in this Court's prior decisions. *See In re Bernard L. Madoff Inv. Sec. LLC,* 424 B.R. 122, 125–32 (Bankr.S.D.N.Y.2010) (*In re BLMIS I*), *aff'd,* Nos. 10–2378, *et al.,* 2011 WL 3568936 (2d Cir. Aug. 16, 2011) (*In re BLMIS II*); *see also Picard v. Merkin (In re Bernard L. Madoff Inv. Sec. LLC),* 440 B.R. 243, 249–51 (Bankr.S.D.N.Y.2010) (*Merkin I*), *leave to appeal denied,* 2011 WL 3897970, at *13 (S.D.N.Y. Aug. 31, 2011) (*Merkin II*).

I. THE DEFENDANTS

A. Peter B. Madoff

Peter B. Madoff ("Peter") is Madoff's brother and was BLMIS's Senior Managing Director and Chief Compliance Officer ("CCO"). He is a law school graduate and held a number of securities licenses with the Financial Industry Regulatory Authority ("FINRA"), including Series 1, 4, and 5. Peter was the Director of the Securities Industry Financial Markets Associations ("SIFMA"), a member of the Board of Governors and the Executive Committee of the National Stock Exchange, the Vice Chairman of the FINRA Board of Governors, as well as a Director of the National Securities Clearing Corporation. He also served on NASDAQ's Executive Committee Board of Governors. Compl. ¶ 6.

As the CCO of BLMIS, Peter was allegedly responsible for adopting and administering compliance procedures to prevent and detect fraud and to identify and address significant compliance issues in accordance with SEC and FINRA regulations. Compl. ¶¶ 28–36. His duties included, *inter alia,* preparing the annual review of BLMIS's investment advisory business's ("IA Business") compliance program, performing qualitative tests of BLMIS's internal compliance procedures, and assessing whether such procedures were effectively implemented. Compl. ¶¶ 28–36.

Peter is alleged to have received at least $60,631,292 from BLMIS, including, but not limited to, withdrawals of fictitious profits from investment advisory accounts at BLMIS ("IA Accounts"); salaries and bonuses from 2001 to 2008 in the total ***102** amount of $20,067,920; loans totaling $13,244,649.30; and various other payments funding purchases of real estate, business investments, a life insurance policy, personal credit card bills, and the purchase and restoration of an Aston Martin automobile.[FN7] Compl. ¶¶ 65–73.

FN7. Peter transferred his ownership interest in the Aston Martin to the Trustee on May 4, 2011. Shortly thereafter, the Trustee won approval from this Court to retain an auctioneer to transport, store, repair and sell the Aston Martin at auction. *See* Order Authorizing the Sale of the Property of the Estate at p. 2 (No. 08–01789) (dated June 15, 2011) (Dkt. No. 4165). In August 2011, the Aston Martin was sold at auction for $225,000. *See*

Notice of Sale of Aston Martin (No. 08–01789)(date Sept. 21, 2011)(Dkt. 4377).

B. Mark D. Madoff and Andrew H. Madoff

Mark D. Madoff ("Mark") and Andrew H. Madoff ("Andrew"), Madoff's sons, were Co–Directors of Trading at BLMIS and served as Controllers and Directors of Madoff Securities International Ltd. ("MSIL"), a U.K. affiliate of BLMIS. [FN8] Both held securities licenses with FINRA, including Series 4, 7, 24, and 55, and were members of various securities organizations. Mark was Chairman of the FINRA Inter–Market Committee, Governor of the Securities Traders Association ("STA"), Co–Chair of the STA Trading Committee, a member of the FINRA Membership Committee and Mutual Fund Task Force, President of the Securities Trader Association of New York ("STANY"), Chairman of the FINRA Regulation District Ten Business Conduct Committee, and Chairman of the Securities Industry and Financial Markets Association ("SIFMA") NASDAQ committee. Similarly, Andrew was Chairman of the Trading, Trading Issues and Technology, and Decimalization and Market Data Committees and Subcommittees at SIFMA. He was also a member of the FINRA District Ten and NASDAQ Technology Advisory Committees. Compl. ¶¶ 7, 8.

FN8. MSIL was placed into liquidation in the U.K. shortly after the commencement of this SIPA liquidation. On April 14, 2009, the joint provisional liquidators for MSIL filed a chapter 15 petition in the United States Bankruptcy Court for the Southern District of Florida seeking recognition of the U.K. liquidation. Following a transfer of that case to the Southern District of New York, this Court granted recognition of the U.K. liquidation as a foreign main proceeding. *See* Order Recognizing Foreign Proceeding at p. 2 (No. 09–12998) (dated June 6, 2009) (Dkt. No. 25).

Andrew and Mark were purportedly responsible for ensuring compliance with BLMIS's policies and procedures, as well as applicable securities laws. Compl. ¶¶ 28–36, 47–49.

Mark allegedly received at least $66,859,311 from BLMIS, including, but not limited to, withdrawals of fictitious profits from IA Accounts; salaries and bonuses from 2001 to 2008 in the total amount of $29,320,830; real estate loans in the amount of $15,126,589; and payments funding real estate purchases, business investments, and personal credit card bills. Compl. ¶¶ 74–84. Likewise, Andrew allegedly received at least $60,644,821 from BLMIS, including, but not limited to, withdrawals of fictitious profits from IA Accounts; $31,105,505 in salary and bonuses between 2001 and 2008; loans totaling $11,285,000; and various other payments funding business investments, the purchase and maintenance of a boat, and personal credit card expenses. Compl. ¶¶ 85–94.

C. Shana Madoff

Shana Madoff ("Shana"), Madoff's niece, served as the in-house Counsel and Compliance Director for BLMIS. She is a law ***103** school graduate and a member of the FINRA Consultative Committee; STANY; NASD's Market Regulation Committee, the SIFMA Self–Regulatory and SRO Committee, and the SIFMA Continuing Education Committee. Compl. ¶ 9.

Like Peter, Shana was purportedly responsible for monitoring BLMIS's operations and ensuring compliance with federal securities laws and regulations and corresponding FINRA rules and regulations. Compl. ¶¶ 28–36, 43–46.

Shana allegedly received at least $10,607,876 from BLMIS, including, but not limited to, withdrawals of fictitious profits from IA Accounts; salaries from 2001 to 2008 in the amount of $3,832,878; as well as various payments funding the purchase of a home, business investments, interior decoration, rent, and personal credit card expenses. Compl. ¶¶ 95–98.

MOTION TO DISMISS UNDER RULE 12(b)(6)
STANDARD OF REVIEW

Rule 12(b)(6) allows a party to move to dismiss a cause of action for "failure to state a claim upon which relief can be granted." FED.R.CIV.P. 12(b)(6); FED. R. BANKR.P. 7012(b). When considering a motion to dismiss under Rule 12(b)(6), a court must accept all factual allegations in the complaint as true and draw all reasonable inferences in the plaintiff's favor. *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S.Ct. 1937, 1949, 173 L.Ed.2d 868 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555–56, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007); *EEOC v. Staten Island Sav.*

Bank, 207 F.3d 144, 148 (2d Cir.2000).

To survive a motion to dismiss, a pleading must contain a "short and plain statement of the claim showing that the pleader is entitled to relief." FED.R.CIV.P. 8(a)(2); FED. R. BANKR.P. 7008. A recitation of the elements of the cause of action supported by mere conclusory statements, however, is insufficient. *Iqbal,* 129 S.Ct. at 1949. Rather, a complaint must state "a plausible claim for relief," *id.* at 1950, which would be the case where "the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged," *id.* at 1949. Finally, in determining plausibility, this Court must "draw on its judicial experience and common sense," *id.* at 1950, to decide whether the factual allegations "raise a right to relief above the speculative level." *Twombly,* 550 U.S. at 555, 127 S.Ct. 1955.

DISCUSSION

I. THE BANKRUPTCY CLAIMS

In Counts Two through Ten of the Complaint, the Trustee seeks to avoid and recover payments totaling $198,743,299 made to or for the benefit of the Defendants pursuant to sections 544, 547, 548, 550, and 551 of the Code and various sections of the NYDCL. The Trustee alleges that more than 383 transfers totaling $141,034,907 to or for the benefit of the Defendants in the six year period (the "Six–Year Transfers") prior to December 11, 2008 (the "Filing Date"),[FN9] and are avoidable and recoverable under sections 544, 550(a), and 551 of the Code and sections 273 through 276 of the NYDCL. Compl. ¶ 106. Of the Six–Year Transfers, at least 129 totaling $58,666,811 were allegedly made within two years prior to the Filing Date (the "Two–Year Transfers") and are avoidable and recoverable***104** under sections 548(a)(1), 550(a), and 551 of the Code. Compl. ¶ 107. Of the Two–Year Transfers, $7,364,048 was received by the Defendants within one year of the Filing Date (the "Preferences") and avoidable and recoverable under Code sections 547, 550(a), and 551. Compl. ¶ 108. Additionally, the Trustee alleges that BLMIS transferred a further $57,708,392 to the Defendants prior to six years before the Filing Date. Compl. ¶ 109. Finally, in Counts Eleven and Twelve of the Complaint, the Trustee requests that the proofs of claims filed by the Defendants in the SIPA Liquidation should be disallowed and equitably subordinated pursuant to relevant sections of the Code.

FN9. On December 11, 2008, Bernard Madoff was arrested by federal agents for violation of criminal securities laws, including, *inter alia,* securities fraud investment adviser fraud, and mail and wire fraud. Contemporaneously, the Securities Exchange Commission filed a complaint in United States District Court for the Southern District of New York. Compl. ¶ 13; *see also In re BLMIS I,* 424 B.R. at 125–32.

A. Actual Fraud Under the Code and the NYDCL

In Counts Three and Five of the Complaint, the Trustee seeks to avoid and recover, under a theory of actual fraud, Two Year Transfers pursuant to section 548(a)(1)(A), and Six Year Transfers under section 544 of the Code and section 276 of the NYDCL (collectively, the "Actual Fraudulent Transfers"). With regard to the Trustee's Actual Fraudulent Transfers claims, although the Complaint adequately alleges the element of intent, it fails, in many instances, to state the factual circumstances constituting the fraud as required by Rule 9(b).

[1] Pursuant to section 548(a)(1)(A) of the Code, a trustee must establish the debtor "made such transfer ... with actual intent to hinder, delay, or defraud." 11 U.S.C. § 548(a)(1)(A). Under section 276 of the NYDCL, a trustee similarly may avoid any "conveyance made ... with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors." NYDCL § 276. A claim brought under either statute must be supported by enough factual allegations to satisfy the pleading requirements set forth under Rule 9(b). *Am. Tissue, Inc. v. Donaldson, Lufkin & Jenrette Sec. Corp.,* 351 F.Supp.2d 79, 106–07 (S.D.N.Y.2004); *Andrew Velez Constr., Inc. v. Consol. Edison Co. of N.Y., Inc. (In re Andrew Velez Constr., Inc.),* 373 B.R. 262, 269 (Bankr.S.D.N.Y.2007). Specifically, the "circumstances constituting fraud or mistake" must be pled with "particularity," but "[m]alice, intent, knowledge, and other conditions of a person's mind" may be pled generally. FED.R.CIV.P. 9(b); FED. R. BANKR.P. 7009.

i. The Trustee Has Adequately Alleged the Element of Intent in His Actual Fraudulent Transfer Claims in Accordance with Rule 9(b)

[2][3] As a matter of law, the "Ponzi scheme

presumption" establishes the debtors' fraudulent intent as required under both the Code and the NYDCL. *Gowan v. The Patriot Group, LLC (In re Dreier LLP)*, 452 B.R. 391, 428 (Bankr.S.D.N.Y.2011). There is a presumption of actual intent to defraud because "transfers made in the course of a Ponzi scheme could have been made for no purpose other than to hinder, delay or defraud creditors." *Id.* at 423; *McHale v. Boulder Capital LLC (In re The 1031 Tax Group)*, 439 B.R. 47, 72 (Bankr.S.D.N.Y.2010) ("If the Ponzi scheme presumption applies, actual intent for purposes of section 548(a)(1)(A) is established as a matter of law.") (internal quotations omitted). The breadth and notoriety of the Madoff Ponzi scheme leave no basis for disputing the application of the Ponzi scheme presumption to the facts of this case, particularly in light of Madoff's criminal admission. *See* ***105***_Picard v. Cohmad Sec. Corp. (In re Bernard L. Madoff Inv. Sec. LLC)_, No. 09–1305, 2011 WL 3274077, at *8 (Bankr.S.D.N.Y. Aug. 1, 2011); *Picard v. Chais (In re Bernard L. Madoff Inv. Sec. LLC)*, 445 B.R. 206, 221 (Bankr.S.D.N.Y.2011); *see also Bear, Stearns Sec. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1, 12 (S.D.N.Y.2007) (relying on transferor's criminal guilty plea to establish the existence of a Ponzi scheme). Moreover, while it is conceivable that "certain transfers may be so unrelated to a Ponzi scheme that the presumption should not apply," the Actual Fraudulent Transfers at issue here, including redemptions of fictitious profits and payments of salaries, "serve[d] to further [the] Ponzi scheme," and are therefore presumed fraudulent. *In re Manhattan Inv. Fund Ltd.*, 397 B.R. at 11.

[4][5][6] The Ponzi scheme presumption applies only to the *transferor's* intent. *See Patriot*, 452 B.R. at 424. The Defendants, however, posit that the *transferee's* fraudulent intent must be established to state a claim under section 276 of the NYDCL. The District Court rejected this precise argument in *Merkin II*, explaining that "relevant cases, together with analysis of the statute, convince the Court that, to state a claim under Section 276, a plaintiff need allege fraudulent intent by only the transferor." 2011 WL 3897970, at *6 (citing *Patriot*, 452 B.R. at 435) (emphasis added); *see also Cohmad*, 454 B.R. at 330 ("[I]t is the transferor's intent alone, and not the intent of the transferee, that is relevant under NYDCL § 276.") (quoting *Patriot*, 452 B.R. at 433); *Gowan v. Wachovia Bank, N.A. (In re Dreier LLP)*, 453 B.R. 499, 510 (Bank.S.D.N.Y.2011) (holding that for the "reasons stated [in *Patriot*], the plaintiff is only required to plead the fraudulent intent of the transferor under DCL § 276"). The District Court reasoned that "transferee's intent ... is material under the statute, but, because Section 278 is an affirmative defense, the transferee's intent should be considered on a full evidentiary record, either at the summary judgment phase or at trial." *Merkin II*, 2011 WL 3897970, at *6. Consequently, "[f]or the purposes of a motion to dismiss, the trustee need state with particularity only the circumstances constituting the fraud and allege the requisite actual intent by the *transferor* to hinder, delay, or defraud creditors." *Id.* (emphasis added). Thus, irrespective of whether an actual fraudulent transfer claim is brought under the Code or the NYDCL, a transferee's good faith "need not be negated by the Trustee in the Complaint" as the Defendants contend. *Cohmad*, 454 B.R. at 330 (quoting *Sec. Inv. Prot. Corp. v. Stratton Oakmont, Inc.*, 234 B.R. 293, 318 (Bankr.S.D.N.Y.1999)).[FN10] The element of intent for each of the Trustee's Actual Fraudulent***106*** Transfer claims is therefore established as a matter of law by virtue of the Ponzi scheme presumption.

FN10. Accordingly, the Defendants' arguments that they "took for value" and "in good faith" are affirmative defenses under sections 548(c) of the Code and 278 of the NYDCL and thus "should be considered on a full evidentiary record, either at the summary judgment phase or at trial." *Merkin II*, 2011 WL 3897970, at *6 (citing *Patriot*, 452 B.R. at 435); *see also Mendelsohn v. Jacobowitz (In re Jacobs)*, 394 B.R. 646, 659 (Bankr.E.D.N.Y.2008) ("An innocent purchaser must affirmatively show good faith in order to take advantage of [NYDCL] section 278(2)."); *Bayou Superfund LLC v. WAM Long/Short Fund II LP (In re Bayou Grp., LLC)*, 362 B.R. 624, 631 (Bankr.S.D.N.Y.2007) ("The good faith/value defense provided in Section 548(c) is an affirmative defense, and the burden is on the defendant-transferee to plead and establish facts to prove the defense."). If the affirmative defense "appears on the face of the complaint," however, an exception to this rule may apply. *Pani v. Empire Blue Cross Blue Shield*, 152 F.3d 67, 74–75 (2d Cir.1998). This exception does not apply here. Indeed, the Trustee suffi-

ciently alleges the Defendants had notice of fraud and were cognizant of the irregularities in their own IA Accounts. Accordingly, the Defendants' affirmative defense of good faith is not a viable ground for dismissal under Rule 12(b)(6).

ii. The Trustee Has Not Identified All of the Actual Fraudulent Transfers with Particularity Under Rule 9(b)

[7][8] The fraudulent intent of the debtor/transferor is one essential element of a *prima facie* claim brought under either section 548(a)(1)(A) of the Code or section 276 of the NYDCL. A second requirement is that the transfers sought to be avoided must be identified with particularity in accordance with Rule 9(b). FED.R.CIV.P. 9(b); FED. R. BANKR.P. 7009. Here, many of the Actual Fraudulent Transfers are not so identified.

[9] To satisfy Rule 9(b)'s particularity requirement, a party must ordinarily allege: "(1) the property subject to the transfer, (2) the timing and, if applicable, frequency of the transfer and (3) the consideration paid with respect thereto." *Pereira v. Grecogas Ltd., (In re Saba Enters., Inc.),* 421 B.R. 626, 640 (Bankr.S.D.N.Y.2009); *see also United Feature Syndicate, Inc. v. Miller Features Syndicate, Inc.,* 216 F.Supp.2d 198, 221 (S.D.N.Y.2002). Where the actual fraudulent transfer claim is asserted by a bankruptcy trustee, however, courts in this district take "a more liberal view ... since a trustee is an outsider to the transaction who must plead fraud from second-hand knowledge." *Nisselson v. Softbank AM Corp. (In re MarketXT Holdings Corp.),* 361 B.R. 369, 395 (Bankr.S.D.N.Y.2007) (quoting *Picard v. Taylor (In re Park South Sec., LLC),* 326 B.R. 505, 517, 516, 518 (Bankr.S.D.N.Y.2005)) (internal quotations omitted). As the Second Circuit recently noted, "[f]raud is endlessly resourceful and the unraveling of weaved-up sins may sometimes require the grant of a measure of latitude to a SIPA trustee." *In re BLMIS,* 654 F.3d 229, 238 n. 7 (granting SIPA trustees discretion to determine the method to calculate net equity).

[10] Of course, "relaxing the particularity requirement" of Rule 9(b) does not "eliminate" it. *Devaney v. Chester,* 813 F.2d 566, 569 (2d Cir.1987). Pleadings still must be particular enough to fulfill Rule 9(b)'s purpose: "to protect the defending party's reputation, to discourage meritless accusations, and to provide detailed notice of fraud claims to defending parties." *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.),* 429 B.R. 73, 92 (Bankr.S.D.N.Y.2010) (citing *In re Everfresh Beverages, Inc.,* 238 B.R. 558, 581 (Bankr.S.D.N.Y.1999)); *see also Shields v. Citytrust Bancorp., Inc.,* 25 F.3d 1124, 1128 (2d Cir.1994) ("[S]ince Rule 9(b) is intended to provide a defendant with fair notice of a plaintiff's claim, to safeguard a defendant's reputation from improvident charges of wrongdoing, and to protect a defendant against the institution of a strike suit ... the relaxation of Rule 9(b)'s specificity requirement for scienter must not be mistaken for license to base claims of fraud on speculation and conclusory allegations."). Such is not the case here where opacity, rather than particularity, best describes the allegations underlying the Trustee's Actual Fraudulent Transfer claims in Counts Three and Five of the Complaint.

To begin with, the Trustee fails to specify which Count he seeks to employ to avoid each Actual Fraudulent Transfer. For example, under Count Three, the Complaint fails to identify which of the Two Year Transfers are additionally Preferences.[FN11] Similarly, with respect Count ***107** Five, the Complaint states $57,708,392 was transferred at some time earlier than six years prior to the Filing Date without specifying how many individual Actual Fraudulent Transfers comprise this sum. The Trustee does not provide how he arrives at: (1) the total sum he seeks to avoid under Counts Three or Five, (2) the total number of discrete Actual Fraudulent Transfers included in each sum, and (3) which statutory look back period he intends to apply to each of these Transfers, and no inference to ameliorate these deficiencies can be drawn on the basis of the allegations contained in the Complaint.

FN11. Pursuant to section 547(b)(4)(B) of the Code, the one year statutory look back period applies because the Complaint sufficiently alleges that the Defendants are "insiders" of BLMIS under section 101(31) of the Code, which defines an "insider" of a debtor corporation as an individual who was, among other things, a director, officer, or person in control of the debtor, or a relative of a director, officer, or person in control of the debtor. 11 U.S.C. §§ 101(31)(B),

547(b)(4)(B).

Second, piecing together the facts contained in the Complaint reveals that the majority of the Actual Fraudulent Transfers are not identified completely. Peter's 1954 Aston Martin provides an illustrative example: allegedly there were four payments totaling approximately $274,562 for its purchase and restoration, but it is not clear how, to whom, or when those payments were made. Compl. ¶ 73; *see Official Comm. of Unsecured Creditors of M. Fabrikant & Sons Inc. v. JPMorgan Chase Bank, N.A. (In re M. Fabrikant & Sons, Inc.)*, 394 B.R. 721, 734 (Bankr.S.D.N.Y.2008) (emphasizing "the Amended Complaint does not identify any specific transfer, transferor, transferee, or date of transfer"); *see also Alnwick v. European Micro Holdings, Inc.*, 281 F.Supp.2d 629, 646 (E.D.N.Y.2003) (dismissing intentional fraudulent transfer claim that failed to identify the assets transferred and identified the date of transfer as "on or about 2001"). Similarly opaque are the allegations that between 2002 and 2008 the Defendants used BLMIS funds to pay company credit card bills that included personal charges. Compl. ¶¶ 73, 84, 94, 98; *see Fed. Nat'l. Mortgage Ass'n v. Olympia Mortgage. Corp.*, No. 04–CV–4971, 2006 WL 2802092, at *2, *9 (E.D.N.Y. Sept. 28, 2006) ("[T]he Amended Complaint ... aggregates the transfers into lump sums over three to five year time periods [and] does not, with respect to each transaction, specify the mechanism of transfer or even the type of property transferred.").

Rectifying the majority of these pleading deficiencies upon amendment should not prove to be a Herculean task. For example, more detailed information appears to be readily accessible to the Trustee given that the Complaint already includes information related to the credit cards used by the Defendants as well as examples of personal charges paid by BLMIS. Compl. ¶¶ 73, 84, 94, 98. Similarly, since the Trustee has indicated that *four* payments were made for the purchase and restoration of the Aston Martin, he likely can specify the method, amount, and date of each of those payments without much difficulty. Compl. ¶ 73. The Complaint as it currently stands, however, has too many porous and disparate factual allegations to provide a legal basis to sustain many of the Trustee's Actual Fraudulent Transfer claims.[FN12] *See Fed. Nat'l. Mortgage Ass'n*, 2006 WL 2802092, at *9 (finding allegations insufficient for the heightened***108** Rule 9(b) pleading standard where the Amended Complaint did "not identify how many transfers plaintiff is challenging or the specific dates and amounts of those transfers"); *Fabrikant*, 394 B.R. at 733 (noting that "[a]llegations that a debtor made an aggregate amount or series of cash or other transfers over a period of time" failed to meet the particularity standard set forth under Rule 9(b)).

> FN12. It bears noting that of the complaints filed by the Trustee in connection with Madoff Ponzi scheme, those that withstood Rule 9(b) scrutiny included multiple exhibits detailing the payments that the Trustee sought to avoid as actual fraudulent transfers. *See, e.g., Cohmad*, 454 B.R. at 329; *Chais*, 445 B.R. at 220; *Merkin I*, 440 B.R. at 258. No such exhibits were attached to the Complaint.

[11] Notwithstanding these pleading deficiencies, the Complaint nevertheless identifies a few Actual Fraudulent Transfers with Rule 9(b) particularity (the "Particularly Pled Actual Fraudulent Transfers"). *See Fed. Nat'l. Mortgage Ass'n.*, 2006 WL 2802092, at *18 (dismissing the Complaint as to all but one actual fraudulent transfer, which was pled with sufficient particularity). For each of these Particularly Pled Actual Fraudulent Transfers, the Complaint alleges the transferee, transferor, and specific dates and amounts: Peter received a $9 million loan from the operating account for BLMIS's IA Business at JP Morgan Chase Bank (the "703 Account") on December 12, 2007, Comp ¶ 73; Mark redeemed $1,956,205 from his IA Account, numbered 1M0142, on or about July 24, 1998, $5,331,853 from his IA Account on or about April 3, 2002, and $1,956,205 from his children's IA Account, numbered 1M0143, on or about July 24, 1998, Compl. ¶¶ 78, 79, 82; and Andrew redeemed $1,956,205 from his IA Account, numbered 1M0140, on or about July 24, 1998, $5,331,853 from his IA Account, numbered 1M0140, on or about April 3, 2002, and $1,956,305 from his children's IA Account, numbered 1M0141, on or about July 24, 1998, Compl. ¶¶ 88, 89, 92. Another two Particularly Pled Actual Fraudulent Transfers [FN13] were made on October 31, 2000 to satisfy capital calls: one from BLMIS's operating account in the amount of $1,223,237.19 satisfied a capital call due to Madoff Technologies LLC by Shana, Compl. ¶ 98, and the second, in the amount of $54,915.25, satisfied a capi-

tal call due to Madoff Technologies LLC by Peter Madoff and came from one of BLMIS's operating accounts, Compl. ¶ , 73; *see* Fed. Nat'l. Mortgage Ass'n, 2006 WL 2802092, at *2 (upholding claim against Samuel Pinter to avoid and recover a transfer of $300,000 that was made from Olympia to Midwood in October 2002 to satisfy a loan taken by Samuel Pinter). Therefore, this is not the death knell of the Complaint.

> FN13. The Court assumes that the Trustee seeks to recover these two transfers under a benefit theory pursuant to section 550(a)(1) of the Code. Compl. ¶ 73 ("[T]he Trustee has identified the following transfers to Peter or *on his behalf* for which BLMIS received no corresponding benefit or value.") (emphasis added); *see also* Stratton Oakmont, Inc., 234 B.R. at 317–18 ("At this juncture, all the Trustee needs to demonstrate is a possible legal theory such that he is allowed to go forward and put on evidence. Although this benefit theory is not explicitly stated in the Complaint, recovery under § 550(a) is not subject to a particularized pleading standard and I am allowed to consider theories that are not articulated, so long as there are facts alleged to support them.").

[12] Accordingly, except with regard to Particularly Pled Actual Fraudulent Transfers, Counts Three and Five [FN14] of the Complaint are dismissed, with leave to ***109** amend the Complaint within forty five days.

> FN14. Count Five's request for attorneys' fees under section 276–a of the NYDCL is not ripe for determination at this early stage. *See* Patriot, 452 B.R. at 435 (finding that "attorneys' fees will only be recoverable if the Trustee establishes at trial actual fraudulent intent by Defendants"); *see also* Cohmad, 454 B.R. at 332 n. 10 ("While the transferee's intent is an element of a claim under section 276–a, unlike under section 276, attorneys' fees will be recoverable provided that the Trustee establishes fraudulent intent on the part of the defendants at trial.").

B. The Trustee Has Sufficiently Pled the Application of the Discovery Rule to Avoid the Particularly Pled Actual Fraudulent Transfers Occurring Prior to Six Years Before the Filing Date

[13] All but one of the Particularly Pled Actual Fraudulent Transfers occurred more than six years prior to the Filing Date. Consequently, these Transfers can be avoided only by invoking New York's "discovery rule," which permits a plaintiff to commence a cause of action predicated on actual fraud within two years of the date the fraud was or should have been discovered with reasonable diligence. NYCPLR §§ 213(8), 203(g); *see* Silverman v. United Talmudical Acad. Torah Vyirah, Inc. (In re Allou Distribs., Inc.), 446 B.R. 32, 67 (Bankr.E.D.N.Y.2011) ("New York state law fixes the limitations period for claims under the DCL. A claim based on actual fraud under DCL Section 276 must be brought within the later of six years from the date of the fraud or conveyance, or two years from the date that the fraud should have been discovered."). For reasons stated below, Trustee has standing under section 544(b) to invoke the discovery rule for the Particularly Pled Actual Fraudulent Transfers that occurred more than six years before the Filing Date.

[14] Pursuant to well-established case law, so long as a bankruptcy trustee provides sufficient notice to the defendants of at least one category of creditors that have standing to avoid an actual fraudulent transfer under non-bankruptcy law, the trustee has standing to assert that actual fraudulent transfer claim under section 544(b) of the Code. *Global Crossing Estate Rep. v. Winnick*, No. 04–CIV–2558, 2006 WL 2212776, at *11 (S.D.N.Y. Aug. 3, 2006) ("[T]o identify the category of creditors with potentially viable claims ... is unquestionably enough to put defendants on notice of the creditors who supply the basis for the right to sue, and will permit them to answer, seek relevant discovery, and defend against these claims."); *see also* Musicland Holding Corp. v. Best Buy Co. (In re Musicland Holding Corp.), 398 B.R. 761, 780 (Bankr.S.D.N.Y.2008) (failing "to locate a case in this district supporting the proposition that the plaintiff must name the qualifying creditor in the complaint, or suffer dismissal"). Indeed, "there is no authority for the proposition that [a bankruptcy trustee] must be more specific than to identify the category of creditors with potentially viable claims" in order to state a claim under section 544 of the Code. *Winnick*, 2006 WL 2212776, at *11; *see In*

re RCM Global Long Term Cap. Appreciation, Fund, Ltd., 200 B.R. 514, 523–24 (Bankr.S.D.N.Y.1996) (holding that pleading the existence of an unsecured creditor with an allowable claim is sufficient); *see also In re Musicland*, 398 B.R. at 780 ("Thus, *RCM* supports the proposition that the plaintiff may plead the existence of the qualifying creditor generally, and prove the existence of an actual, qualifying creditor at trial.").

The Complaint provides sufficient notice to the Defendants of at least one category of creditors on whose claims the Trustee bases his standing to avoid transfers under New York's discovery rule: defrauded BLMIS customers. Specifically, it states that "[a]t all times relevant to transfers, the fraudulent scheme perpetrated by BLMIS was not reasonably discoverable by at least one unsecured creditor of BLMIS," Compl. ¶ 161, and that "[a]t all times relevant to the transfers, there have been one or more creditors who have held and still hold matured or unmatured unsecured***110** claims against BLMIS that were and are allowable...." Compl. ¶ 162. These allegations, when viewed in conjunction with the aforementioned case law, compel this Court to conclude the Trustee has standing under section 544(b) of the Code to avoid and recover the Particularly Pled Actual Fraudulent Transfers made more than six years before the Filing Date.

C. Constructive Fraud Under the Code and the NYDCL

In Counts Four, Six, Seven, and Eight of the Complaint, the Trustee seeks to avoid and recover, under a theory of constructive fraud, Two Year Transfers pursuant to section 548(a)(1)(B) of the Code, and Six Year Transfers under section 544 of the Code and sections 273–275 of the NYDCL (collectively the "Constructive Fraudulent Transfers"). This Court finds most, but not all, of the allegations corresponding to the Constructive Fraudulent Transfers provide sufficient information to sustain the Trustee's avoidance claims under the liberal pleading standards of Rule 8(a), as set forth below.

[15][16] Section 548(a)(1)(B) of the Code requires the Trustee to show, *inter alia,* BLMIS did not receive "reasonably equivalent value" for any of the transfers alleged to be fraudulent. 11 U.S.C. § 548(a)(1)(B). Similarly, under sections 273 through 275 of NYDCL, the Trustee must demonstrate BLMIS did not receive "fair consideration" for the same. NYDCL §§ 273–275. It has been found, " 'reasonably equivalent value' in Section 548(a)(1)(B), [and] 'fair consideration' in the [NYDCL] ... have the same fundamental meaning." *Balaber–Strauss v. Sixty–Five Brokers (In re Churchill Mortgage Inv. Corp.)*, 256 B.R. 664, 677 (Bankr.S.D.N.Y.2000) *(Churchill I), aff'd, Balaber–Strauss v. Lawrence*, 264 B.R. 303 (S.D.N.Y.2001) (*Churchill II*). Fair consideration can be established by showing either a lack of "fair equivalent" property or a lack of good faith on the part of the transferee. NYDCL § 272 (defining "fair consideration"); *see Patriot*, 452 B.R. at 443 ("To defeat a motion to dismiss, the Trustee need only allege a lack of 'fair consideration' by pleading a lack of 'fair equivalent' value or a lack of good faith on the part of the transferee."); *Silverman v. Sound Around, Inc. (In re Allou Distribs., Inc.)*, 404 B.R. 710, 716 (Bankr.E.D.N.Y.2009) ("[F]air consideration has two components—the exchange of fair value and good faith—and both are required.") (internal quotations omitted).[FN15]

> FN15. Contrary to the Defendants' position, BLMIS was insolvent at the time of the Constructive Fraudulent Transfers given that Ponzi schemes are, by definition, at all times insolvent. *See Armstrong v. Romano*, Nos. 01 Civ. 2437, *et. al.*, 2010 WL 1141158, at *20 (S.D.N.Y. Mar. 24, 2010); *Daly v. Deptula (In re Carrozzella & Richardson)*, 286 B.R. 480, 486 n. 17 (D.Conn.2002) ("[A] number of courts have held that an enterprise engaged in a Ponzi scheme is insolvent from its inception and becomes increasingly insolvent as the scheme progresses."); *see also Cunningham v. Brown*, 265 U.S. 1, 8, 44 S.Ct. 424, 68 L.Ed. 873 (1924) (noting Charles Ponzi, the namesake of the Ponzi scheme, "was always insolvent, and became daily more so, the more his business succeeded. He made no investments of any kind, so that all the money he had at any time was solely the result of loans by his dupes.").

[17][18][19] Under both the Code and the NYDCL, courts consistently hold that "claims of constructive fraud do not need to meet the heightened pleading requirements of Fed.R.Civ.P. 9(b)." *Bank of Commc'ns v. Ocean Dev. Am., Inc.*, No. 07–CIV–

4628, 2010 WL 768881, at *6 (S.D.N.Y. Mar. 8, 2010). Rather, the Trustee need only satisfy Rule 8(a) by providing a "short and plain statement of ***111** the claim showing that [he] is entitled to relief." FED.R.CIV.P. 8(a)(2); *see also Enron Corp. v. Granite Constr. Co. (In re Enron Corp.)*, No. 03–93172, 2006 WL 2400369, at *5 (Bankr.S.D.N.Y. May 11, 2006) ("The Court does not see any reason to break with its precedent in applying Rule 8(a) in evaluating the pleadings in a constructive fraudulent conveyance matter herein."); *Stratton Oakmont, Inc.*, 234 B.R. at 319 ("The pleading of constructive fraud [under the NYDCL], as opposed to actual fraud, must only comply with F.R.C.P. 8(a)...."). The purpose of this pleading requirement is to ensure that the defendant receives "fair notice of what the ... claim is and the grounds upon which it rests." *Scheidelman v. Henderson (In re Henderson)*, 423 B.R. 598, 612 (Bankr.N.D.N.Y.2010) (quoting *Twombly*, 550 U.S. at 545, 127 S.Ct. 1955) (internal quotations omitted). Indeed, "the sole consideration should be whether, consistent with the requirements of Rule 8(a), the complaint gives the defendant sufficient notice to prepare an answer, frame discovery, and defend against the charges." *Nisselson v. Drew Indus., Inc. (In re White Metal Rolling & Stamping Corp.)*, 222 B.R. 417, 429 (Bankr.S.D.N.Y.1998) (internal citations omitted).

[20] The Defendants concede that Rule 9(b) is typically not applicable because the conduct of the transferee is normally irrelevant to constructive fraud, which merely looks at the value given and the solvency of the transferor. They contend nevertheless that Rule 9(b) does apply in the instant proceeding because the underlying allegations sound in fraud. But not every allegation of wrongful conduct sounds in fraud for purposes of Rule 9(b); the Trustee has not alleged, and need not allege for purposes of constructive fraud, that the Defendants were involved in the kind of misrepresentation or deceit that would require a heightened pleading standard. Instead, the only relevant allegation to this Constructive Fraudulent Transfer claim is that the Defendants breached fiduciary duties by failing to perform compliance responsibilities and therefore did not provide value for their wages. Such a breach of a fiduciary duty does not implicate Rule 9(b). *See Official Comm. of Unsecured Creditors v. Donaldson, Lufkin & Jenrette Secs. Corp.*, No. 00 Civ. 8688, 2002 WL 362794, at *8 (S.D.N.Y. Mar. 6, 2002) (holding breaches of fiduciary duties "by conduct not amounting to fraud, *such as by breaching its duties of care, disclosure and loyalty* " do not require the heightened standards of Rule 9(b)) (emphasis added). Furthermore, the Second Circuit has indicated that Rule 8(a) applies to constructive fraud claims even in cases where the courts consider the transferee's knowledge of the fraud and underlying conduct. *See Sharp Int'l Corp. v. State St. Bank & Trust Co. (In re Sharp Int'l Corp.)*, 403 F.3d 43, 53–54 (2d Cir.2005) (discussing constructive fraud and raising Rule 9(b) only in subsequent discussions of actual fraud); *Silverman v. Actrade Capital, Inc. (In re Actrade Fin. Techs. Ltd.)*, 337 B.R. 791, 801 (Bankr.S.D.N.Y.2005) ("[I]n [*Sharp*], the Second Circuit considered a motion to dismiss a complaint that asserted claims of constructive and intentional fraudulent conveyance under New York State law. It held that the intentional fraud claims had to be pleaded in compliance with Rule 9(b) but did not imply that the constructive fraud claims had to meet any such requirement.").

i. The Trustee Has Sufficiently Pled that BLMIS Did Not Receive Value for Purposes of Constructive Fraud Under the Code and the NYDCL

[21] The Constructive Fraudulent Transfers that the Trustee seeks to avoid include Defendants' withdrawals of fictitious***112** profits and receipt of salaries, bonuses, gifts, and loans from BLMIS. The Trustee has adequately alleged all of the Constructive Fraudulent Transfers were made for less than "reasonably equivalent" or "fair equivalent" value.

[22] With respect to the Defendants' withdrawals of profits from their BLMIS IA Accounts, courts have consistently held that fictitious profits from a Ponzi scheme are deemed to have been received for less than reasonably equivalent value and can be avoided. *See Sender v. Buchanan (In re Hedged–Inv. Assoc., Inc.)*, 84 F.3d 1286, 1290 (10th Cir.1996) (holding payments in excess of original investment do not provide any value); *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir.1995) ("The paying out of profits to [the defendant] not offset by further investments by him conferred no benefit on the corporations...."); *In re Bayou Grp., LLC*, 439 B.R. 284, 338 (S.D.N.Y.2010) ("Because Appellants provided no value in exchange for the fictitious profits they received, that portion of their redemption payments is voidable as a constructive fraudulent conveyance."); *Patriot*, 452 at 440 n. 44 ("The Court's conclusion that the Defendants did not provide reasonably

equivalent value for the payments in excess of principal is consistent with those courts that have held that investors in a Ponzi scheme are not entitled to retain the fictitious profits they received."). In addition, the Trustee's allegations, if proven, show that BLMIS received nothing in return for the gifts and loans the Defendants received. Although promissory notes were exchanged for some of these Constructive Fraudulent Transfers, the Trustee has sufficiently alleged such notes were executed *pro forma* without intent to repay. In particular, the Trustee could not find any payment of principal, interest, or otherwise that was given in exchange for the loans since the time they were made, which in some instances dates back to 2003.

[23] The Defendants unsuccessfully argue that their services constituted reasonably equivalent value and fair consideration given to BLMIS in exchange for their salaries. In support of this contention, the Defendants rely upon *Churchill I* where the court found the brokers provided value for the commissions they received by performing their duties. 256 B.R. at 667. The Defendants posit that their salaries cannot be avoided since, they claim, the Trustee has not alleged their salaries "were disproportionate to like commissions paid for like services in the marketplace ... by similar but legitimate business entities." *Id.* at 679. The Defendants are mistaken: the Trustee has sufficiently alleged they breached fiduciary duties to BLMIS, and thus did not provide services that might otherwise have constituted adequate consideration in exchange for their receipt of salaries and bonuses. *See* Section II.C. *infra.*

Notwithstanding the Defendants' arguments to the contrary, this conclusion is consistent with the decision in *Churchill I.* There, the trustee sought to recover commissions paid to brokers by debtors for bringing investors into a Ponzi scheme, on the theory that services enlarging the scope of the debtors fraudulent scheme do not give value. In rejecting the trustee's theory, the *Churchill I* court reasoned that the debtors' involvement in a fraudulent enterprise did not determine whether value was given under section 548 of the Code. 256 B.R. at 679. The focus, instead, should be on the specific transaction, and a court should concentrate on the "value of the goods and services provided rather than on the impact the goods and services had on the bankrupt enterprise." *Id.* at 680. The court in *Churchill I* went on to hold that because the trustee conceded ***113** there was nothing unlawful or fraudulent in the way the brokers were hired or carried out their duties, the brokers "earned what they were paid fairly and without wrongdoing," and the claims to recover their commissions dismissed as a matter of law. *Id.*

In contrast to *Churchill I,* where the brokers faithfully carried out their duties, the Trustee here takes direct aim at the "astronomical" compensation—including payments to Mark and Andrew of $4.8 million in 2006 and over $9 million in 2007—that was paid despite the Defendants' *failure to fulfill their employment duties.* Compl. ¶¶ 74, 85. Therefore, even if the Defendants' wages were proportionate to the wages of senior management in legitimate enterprises, a fact the Trustee does not concede, the Defendants returned less than reasonable equivalent value to BLMIS as a result of their alleged lack of faithful service. *See Churchill I,* 256 B.R. at 684 ("Nor shall this decision prejudice the Trustee's right to assert fraudulent conveyance claims based upon evidence showing that commissions were paid (for example, to insiders) that exceeded the value of broker services.").

In any event, the Court need not make a finding as to whether the Defendants' services constituted adequate value, as these issues often involve factual inquiries inappropriate for a motion to dismiss. *In re Actrade Fin. Techs. Ltd.,* 337 B.R. at 804 ("[T]he question of reasonably equivalent value ... is fact intensive, and usually cannot be determined on the pleadings."). At this early stage, the Trustee has adequately pled a lack of reasonably equivalent value with regard to the transfers for purposes of section 548(a)(1)(B) of the Code and sections 273 through 275 of the NYDCL.

ii. The Trustee Has Pled Nearly Every Constructive Fraudulent Transfer in Satisfaction of Rule 8(a)

[24][25] In accordance with the liberal pleading requirements of Rule 8(a), "[t]he plaintiff need not provide specific facts to support its allegations." *Fabrikant,* 394 B.R. at 735 (quoting *Erickson v. Pardus,* 551 U.S. 89, 127 S.Ct. 2197, 167 L.Ed.2d 1081 (2007)). This is because Rule 8(a) does not require that "a complaint be a model of clarity or exhaustively present the facts alleged, as long as it gives each defendant fair notice of what the plaintiff's claim is

and the facts upon which it rests." *Anwar v. Fairfield Greenwich Ltd.*, 728 F.Supp.2d 372, 422 (S.D.N.Y.2010) (internal quotations and citations omitted). Indeed, courts have found that allegations aggregating transfers into lump sums over several years without identifying the number of transfers, the dates of the transfers, or the amount of any specific transfer will satisfy Rule 8(a) pleading requirements. *See, e.g., The Unencumbered Assets, Trust v. JP Morgan Chase Bank (In re Nat'l Century Fin. Enters., Inc. Inv. Litig.)*, 617 F.Supp.2d 700, 722 (S.D.Ohio 2009) ("Though the complaint fails to specify the exact dates and amounts of the dividend payments, this claim is subject to Rule 8's liberal pleading standard...."); *Fed. Nat'l Mortgage Ass'n*, 2006 WL 2802092, at *9 (finding complaint alleged constructively fraudulent transfers despite aggregating "the transfers into lump sums over three to five year time periods" without identifying the mechanism of the transfer).

[26][27] Accordingly, many of the allegations underlying the Constructive Fraudulent Transfers in the Complaint satisfy the notice pleading standard of Rule 8(a), including a number of the allegations that aggregate these Transfers over several years. For instance, the Trustee's allegation that $6,645,000 was ***114** transferred to Mark's attorney in May and June of 2008 for the purchase of a Nantucket home provides sufficient information to apprise the Defendants of the claim.[FN16] Compl. ¶ 84. The facts surrounding these Constructive Fraudulent Transfers provide Mark with sufficient notice of what the Trustee intends to prove; namely, that a transfer of $6,645,000 for the purchase of a home is avoidable under the Code and the NYDCL because Mark provided less than reasonably equivalent value to BLMIS, while it was insolvent. Similarly, the Complaint aggregates Constructive Fraudulent Transfers over the six years (the "Six Year Aggregations"), and consequently fails to identify whether any of these Transfers, occurred within two years of the Filing Date. For example, withdrawals by Mark and Andrew of at least $7.3 million from IA Accounts after April 2004, Compl. ¶¶ 80, 90, and transfers between 2002 and 2008 to pay for personal expenses charged to the Defendants' credit cards. Compl. ¶¶ 73, 84, 94, 98. While it is unclear what amount is sought as avoidable under the Code and what amount is sought under the NYDCL, the Defendants have notice of the Trustee's allegations that the Defendants provided insufficient value for the Six Year Aggregations at a time that BLMIS was insolvent. As such, the allegations contain sufficient information for Defendants to prepare for litigation on the merits, satisfying Rule 8(a). *See Fabrikant*, 394 B.R. at 736 (holding Rule 8(a) was satisfied despite the complaint aggregating transfers over "a period lasting nearly four years" and it was impossible to determine what amount was sought under the Code).

> FN16. These are just illustrative examples of some of the many Constructive Fraudulent Transfers that have been adequately pled. Only those identified in the following paragraphs have not been so pled.

[28][29] Other allegations are not as satisfactory. Certain aggregations in the Complaint (the "Longer Aggregations") [FN17] include transfers that extend beyond any applicable look-back period [FN18] and it is unclear which ones, if any, the Trustee seeks to avoid as constructively fraudulent. Other transfers are listed in the Complaint without providing any date associated with the transfer (the "Undated Transfers"),[FN19] ***115** and this Court is unable to determine whether the Trustee is even seeking to avoid them as constructively fraudulent. To the extent that the Court is unable to determine whether a transfer falls under the look-back period of any applicable law, the Trustee's claim to avoid it as a Constructive Fraudulent Transfer fails under Rule 8(a) to provide "the defendant fair notice of what the ... claim is and the grounds upon which it rests." *Erickson*, 551 U.S. at 93, 127 S.Ct. 2197 (internal quotations omitted) (emphasis added).

> FN17. The Longer Aggregations include: (1) the Defendants' salaries and bonuses between 2001 and 2008, Compl. ¶¶ 65, 74, 85, 96 (this does not include the $4.8 million dollar bonus to both Mark and Andrew in 2006 which has been properly pled under the NYDCL, and the bonus of over $9 million dollars to both Mark and Andrew in 2007 which has been properly pled under the Code and the NYDCL, Compl. ¶¶ 74, 85); (2) transfers from BLMIS between 1996 and 2008 funding a life insurance policy for Peter, Compl. ¶ 73; (3) payments on Peter's behalf between January 18, 2000 and April 11, 2006 to limited partnerships where Peter was an investor, Compl. ¶ 73; (4)

payments in 2002 to the Beacon Point Marine in Connecticut where Andrew kept a boat, Compl. ¶ 94; (5) payments in 2001 and 2002 to "Lock and Hackle," a fly fishing and hunting membership club in Miami, Florida on Andrew's behalf, Compl. ¶ 94; and (6) Shana's withdrawals of fictitious profits from her IA Account prior to December 2008, Compl. ¶ 97.

FN18. In the context of constructive fraud, the New York discovery rule is not available to allow a plaintiff to avoid transfers occurring more than six years before the Filing Date. *See* Tenamee v. Schmukler, 438 F.Supp.2d 438, 446 (S.D.N.Y.2006) ("The statute of limitations for ... constructive fraud is six-years, although unlike the case of actual fraud the two year discovery rule does not apply."); *Williams v. Infra Commerc Anstalt*, 131 F.Supp.2d 451, 456 (S.D.N.Y.2001) (holding constructive fraud claims under the NYDCL do "not receive the benefit of the discovery rule, since actual intent to defraud is not an element of that statute").

FN19. The Undated Transfers are: (1) payments from BLMIS to finance Peter's, Mark's, and Andrew's ownership stakes in Madoff Brokerage Trading and Technology, LLC, Compl. ¶ 73, 84, 94; (2) payment by BLMIS of to fund Peter's share of a capital call by Madoff Technologies, LLC, Compl. ¶ 73; and (3) payments by MSIL for the purchase and restoration of Peter's Aston Martin automobile, Compl. ¶ 73.

While discovery is sometimes necessary to assist a trustee in clarifying the circumstances surrounding particular Constructive Fraudulent Transfers—for instance when the trustee has no access to the debtor's books and records or the books and records are in shambles—the Trustee here has not provided any such explanation. Accordingly, the Motions to Dismiss the Trustee's Constructive Fraudulent Transfer claims are granted with respect to the Longer Aggregations and the Undated Transfers, with leave to amend the Complaint within forty five days. As to the remainder of the Trustee's Constructive Fraudulent Transfer claims, the Motions to Dismiss are denied.

iii. Section 546(e) Does Not Provide a Basis for Dismissing The Trustee's Constructive Fraudulent Transfer Claims

[30] Mark and Andrew unsuccessfully argue their withdrawals of fictitious profits are insulated from liability by the "safe harbor" of section 546(e) of the Code, which provides, in relevant part, that "the trustee may not avoid ... [a] settlement payment ... made by or to (or for the benefit of) a ... stockbroker ... in connection with a securities contract." 11 U.S.C. § 546(e). "Settlement payment" is defined as a "preliminary settlement payment, a partial settlement payment, an interim settlement payment ... or any other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8). A "stockbroker" is a person who has a customer and "that is engaged in the business of effecting transactions in securities." 11 U.S.C. § 101(53A)(A), (B). A "securities contract" is defined as, *inter alia,* "a contract for the purchase, sale, or loan of a security." 11 U.S.C. § 741(7)(A)(i)-(xi). Mark and Andrew contend that the Constructive Fraudulent Transfers made from their IA Accounts are settlement payments by a stockbroker pursuant to a securities contract, and thus cannot be avoided. *See* Memorandum of Law in Support of Defendants Mark and Andrew Madoff's Motion to Dismiss at p. 38, 39 (No. 09–01503) (dated March, 15, 2010) (Dkt. No. 13) [Hereinafter "Mark and Andrew Mot."].

In *Merkin I,* this Court addressed virtually identical arguments, and found that they were at best premature, as section 546(e) provides an affirmative defense that, unless clearly established on the face of the Complaint, does not tend to controvert the Trustee's *prima facie* case. 440 B.R. at 266; *see also Merkin II*, 2011 WL 3897970, at *12 ("This Court finds no substantial grounds for difference of opinion as to the correctness of the standards relied on by the Bankruptcy Court in its refusal—at the pleading stage—to dismiss on the grounds of ... 546(e) [is an] affirmative defense."); ***116***DeGirolamo v. Truck World, Inc. (In re Laurel Valley Oil Co.)*, No. 07–6109, 2009 WL 1758741 (Bankr.N.D.Ohio June 16, 2009). Assuming, *arguendo,* that the section 546(e) defense were timely, the Court cannot find as a matter of law that it applies to the transactions at issue. Whether Madoff, through BLMIS, was a stockbroker "engaged in the business of effecting transactions in

securities" is dubious. 11 U.S.C. § 101(53A)(B). Courts have held that Ponzi scheme operators do not affirmatively "make securities transactions happen" on behalf of legal "customers," and thus do not fit the definition of "stockbroker" for purposes of section 546(e). *See Johnson v. Neilson (In re Slatkin)*, 525 F.3d 805, 817 (9th Cir.2008); *Wider v. Wootton*, 907 F.2d 570, 573 (5th Cir.1990). As asserted in the Complaint, Madoff, through BLMIS, "never in fact purchased any of the securities he claimed to have purchased for customer accounts." Compl. ¶ 25; *see Merkin II*, 2011 WL 3897970, at *12 (finding "no substantial grounds for difference of opinion" with this Court's determination in *Merkin I* that Madoff is not a stockbroker as a matter of law); *see also Merkin I*, 440 B.R. at 266–68.

[31] For the same reason, it is doubtful whether the payments from BLMIS to the Defendants are settlement payments as contemplated by the statute. Settlement payments subject to the safe harbor of section 546(e) must be made in the context of a "securities transaction." *See In re Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 09–5122, 09–5142, 2011 WL 2536101, at *7 (2d Cir. June 28, 2011) (noting "[w]e like our sister circuits, agree that in the context of the securities industry a settlement refers to the completion of a securities transaction....") (internal quotations omitted); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 985 (8th Cir.2009); ("[A] settlement payment is generally the transfer of cash or securities made to complete the securities transaction.") (internal quotations and citations omitted); *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 849 (10th Cir.1990) (explaining settlement is "the completion of a securities transaction"); *Jackson v. Mishkin (In re Adler, Coleman Clearing Corp.)*, 263 B.R. 406, 475 (S.D.N.Y.2001) ("The term 'settlement' as commonly used in connection with purchases and sales in the securities trade refers to acts that occur at different states of the process towards completion of the securities transaction."). While the Second Circuit recently defined "transaction in securities" broadly, *In re Enron Creditors Recovery Corp.*, 651 F.3d at 335–37 (holding settlement payment does not require change in ownership of the security and limiting the requirement of "commonly used in the securities trade" in connection with settlement payments), it suggested that "settlement payments" must be made in relation to an actual securities transaction, *id.* at 336–37 ("Because Enron's redemption payments *completed a transaction in securities,* we hold that they are settlement payments within the meaning of § 741(8)."") (emphasis added); *see also Official Comm. of Unsecured Creditors of Quebecor World (USA) Inc. v. Am. United Life Ins. Co. (In re Quebecor World (USA) Inc.)*, No. 08–01417, 2011 WL 3157292, at *11 (Bankr.S.D.N.Y. July 27, 2011) ("The practical effect of the [Enron] opinion is to make it more difficult for a plaintiff ... to maintain a viable cause of action for avoidance in relation to prepetition transfers made to complete *a transaction involving a security.*") (emphasis added). Here, where securities may never have been bought, sold, or otherwise existent at BLMIS, withdrawals from IA Accounts may not constitute "settlement payments" under section 546(e) of the Code. Certainly in this case, where the Defendants received astronomical returns on comparably ***117** negligible investments,[FN20] the Trustee is entitled to discovery in order to ascertain the extent of the Defendants' knowledge about the fraudulent activities affecting their IA Accounts.

> FN20. Specifically, Andrew invested only $912,062 into IA Accounts, yet he redeemed $17,117,566; Mark invested only $745,482 into IA Accounts, yet he redeemed $18,105,456; Peter invested only $32,146 into IA Accounts, yet he redeemed $16,252,004; and Shana invested only $1,364,975 into IA Accounts, yet she redeemed $1,666,436. Compl. ¶¶ 66, 76, 86, 97. Additionally, some IA Accounts showed purported gains despite lacking any principal to support such gains. Compl. ¶¶ 67, 77–80, 87–90.

Additionally, even if BLMIS were a stockbroker, the Court is unable to conclude that a "securities contract" ever existed. The Defendants do not explain what qualifies as an investment contract in this case and merely conclude that "the Bankruptcy Code's definition of a 'securities contract' certainly covers the transactions here." Mark and Andrew Mot. at p. 39. Surely the IA Account agreements are not investment contracts as a matter of law; this Court has previously questioned whether they effect "the purchase, sale, or loan of a security" between the parties or contemplate any particular security transaction. 11 U.S.C. § 741(7)(A). At most, they merely authorize Madoff to act as "agent and attorney in fact to buy, sell and trade in stocks, bonds, options and any other

securities" in the future on the Fund Defendants' behalf. *See* Merkin I, 440 B.R. at 267.

[32] Moreover, as this Court has previously held, the application of section 546(e) must be rejected as contrary to the purpose of the safe harbor provision and incompatible with SIPA. Section 546(e) was intended to promote stability and instill investor confidence in the commodities and securities markets. *Merkin I*, 440 B.R. at 267 (citing H. Rep. No. 97–420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583 (stating the purpose of 546(e), as amended, is to protect "the stability of the market")); *Mishkin v. Ensminger (In re Adler, Coleman Clearing Corp.)*, 247 B.R. 51, 105 (Bankr.S.D.N.Y.1999) (stating that a goal of 546(e) is to "promote investor confidence"). Courts have held that to extend safe harbor protection in the context of a fraudulent securities scheme would be to "undermine, not protect or promote investor confidence ... [by] endorsing a scheme to defraud SIPC," and therefore contradict the goals of the provision. *Id.* (declining to extend section 546(e)'s safe harbor protection to a party implicated in a fraudulent scheme). Further, in the context of a SIPA proceeding, applying the safe harbor provision would negate its remedial purpose by eliminating most avoidance powers granted to a trustee under SIPA. *See* 15 U.S.C. §§ 78fff(b), 78fff–2(c)(3).[FN21] Simply put, the Constructive Fraudulent Transfers sought to be avoided emanate from Madoff's massive Ponzi scheme, and the safe harbor provision does not insulate transactions like these from attack. Indeed, it defies credulity that the Defendants, who are insiders on the basis of the facts alleged, were ever contemplated to be the parties eligible to invoke the safe harbor provision under section 546(e).

> FN21. Significantly, in the context of a SIPA proceeding, the Code provisions, including section 546(e), are incorporated only "*to the extent consistent with the provisions of [SIPA].*" SIPA § 78fff(b) (emphasis added).

In light of the foregoing, I hold that the Defendants' arguments under section 546(e) fail to establish a basis for dismissing the Trustee's Constructive Fraudulent Transfer claims.

***118 D. The Trustee Has Failed To Adequately Allege Preference Claims**

The Trustee has insufficiently pled Count Two of the Complaint to avoid and recover Preferences.

i. The Trustee Has Adequately Pled the Statutory Elements of a Preference Claim

[33] Section 547(b) of the Code provides that a trustee may avoid a transfer from BLMIS, if the transfer is made to or for the benefit of a creditor, for or on account of an antecedent debt, while the debtor was insolvent, and within one year before the date of the filing of the petition if the creditor was an insider, as well as allows such creditor to receive more than it would in a chapter 7 liquidation. 11 U.S.C. § 547(b). Claims to avoid and recover preferential payments are not held to the heightened pleading requirements of Rule 9(b). *See Family Golf Ctrs., Inc. v. Acushnet Co. (In re Randall's Island Family Golf Ctrs.)*, 290 B.R. 55, 64 (Bankr.S.D.N.Y.2003). Accordingly, under Rule 8(a), the Trustee must provide only a "short and plain statement of the claim showing that [he] is entitled to relief." FED.R.CIV.P. 8(a)(2).

[34][35][36] The Trustee has adequately pled the requisite elements with regard to the Preferences. The Trustee has sufficiently alleged the Defendants are insiders of BLMIS subject to a one-year preference look back period, as all of the Defendants are close relatives of Madoff and were officers or senior managers at BLMIS. *See* 11 U.S.C. § 101(31)(B) (defining insiders of a corporate debtor to include officers of the debtor and "relative [s] of a general partner, director, officer, or person in control of the debtor"). Additionally, as discussed above, Ponzi schemes are presumptively insolvent, and the Trustee need not allege specific facts supporting the insolvency of BLMIS at the times of the preferential transfers. Finally, the Trustee alleges the Preferences were compensation for services performed by the Defendants prior to payment, and suffice to show the payments were to a creditor on account of an antecedent debt. *See Pryor v. Cohen (In re Blue Point Carpet, Inc.)*, 102 B.R. 311, 320–21 (Bankr.E.D.N.Y.1989) (finding that salary payments paid on the date due were avoidable preferences).[FN22]

> FN22. Salary payments are often subject to the affirmative defenses enumerated in section 547(c) of the Code, such as transfers made in the ordinary course of business. *See* 11 U.S.C. § 547(g) ("[T]he creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the

non-avoidability of a transfer under subsection (c) of this section."); *Lawson v. Ford Motor Co. (In re Roblin Indus., Inc.)*, 78 F.3d 30, 39 (2d Cir.1996) ("A creditor asserting the [ordinary course of business] defense bears the burden of proving each of the three elements by a preponderance of the evidence."). As no Defendant has raised these affirmative defenses and their applicability is not clear from the face of the Complaint, the court need not address at this time whether they apply to defeat the Preference claims.

ii. The Trustee Has Not Identified the Preferences with Sufficient Information

[37] The Trustee's Preference claims fail to provide the minimum information required by Rule 8(a). The Trustee's allegations aggregate the transfers into a lump sum without specifying the number of Preferences, the amount of any specific Preference, or which defendant received any specific Preference.[FN23] While Rule 8(a) does not require specific factual detail, ***119** such bare allegations fail to provide sufficient notice for the Defendants to prepare an answer or affirmative defenses, such as whether the transfer was made in the ordinary course of business or whether there was a contemporaneous exchange for new value. *See State Bank and Trust Co. v. Spaeth (In re Motorwerks, Inc.)*, 371 B.R. 281, 293–94 (Bankr.S.D.Ohio 2007). The allegations here are dissimilar to the trustee's allegations in *Court–Appointed Receiver for Lancer Management Group LLC v. 169838 Canada, Inc.*, where the court found that the Complaint contained sufficient factual information despite "lumping" the defendants together without identifying the transfers attributable to each Defendant. No. 05–60235–CIV, 2008 WL 2262063, at *3 (S.D.Fla. May 30, 2008). In that case, the complaint contained an exhibit indicating the particular transfers from particular funds on particular dates, and accordingly provided sufficient information for the defendants to form an answer despite not identifying which defendant received which transfer. Here, by contrast, the Preferences and the Defendants are both grouped together without any specifics provided. Again, while dismissal might not be required in all such circumstances, the Trustee has not come forth with any explanation for these minimalistic pleadings. The Trustee's Preference claims in Count Two are therefore dismissed with leave to amend within forty five days.

FN23. The only allegation in the Complaint specific to the Preferences is that "the compensation payments received by the four ... Defendants during the period from December 11, 2007[to] the Filing Date in the collective amount of $7,364,048 were made during the one year period prior to the Filing Date and are additionally recoverable as avoidable preference payments...." Compl. ¶ 108. The Complaint does not contain any facts or allegations that sufficiently detail the specific transfers made within one year of the Filing Date.

E. The Trustee Fails to Adequately Plead his Claims To Recover Subsequent Transfers From the Defendants

[38] The Trustee has insufficiently pled Count Ten of the Complaint to recover funds subsequently transferred to the Defendants (the "Subsequent Transfers") under section 550(a)(2) of the Code and section 278 of the NYDCL. *See* 11 U.S.C. § 550(a)(2) (allowing recovery from "any immediate or mediate transferee of such initial transferee"); NYDCL § 278 (allowing recovery from "any person"); *Farm Stores, Inc. v. Sch. Feeding Corp.*, 477 N.Y.S.2d 374 (N.Y.App.Div.1984) ("*[E]ach transferee* ... is liable to the creditor to the extent of the value of the money or property he or she wrongfully received.") (emphasis added).

[39] In determining whether a claim to recover fraudulent transfers from a subsequent transferee is adequately pled, Rule 8(a) governs. *Stratton Oakmont, Inc.*, 234 B.R. at 317–18 ("[R]ecovery under § 550(a) is not subject to a particularized pleading standard...."); *see Silverman v. K.E.R. U. Realty Corp. (In re Allou Distribs., Inc.)*, 379 B.R. 5, 30 (Bankr.E.D.N.Y.2007) (indicating "in order to prove a Section 550(a)(2) claim, [the] burden is not so onerous as to require 'dollar-for-dollar accounting' of 'the exact funds' at issue" and that "if dollar-for-dollar accounting is not required at the proof stage, then surely it is not required at the pleading stage either"). The purpose of this pleading requirement is to ensure the defendant receives "fair notice of what the ... claim is and the grounds upon which it rests." *In re Henderson*, 423 B.R. at 612 (internal quotations omitted).

Here, the Complaint merely alleges that "[o]n information and belief, some or all of the transfers were subsequently transferred by one or more [of the Defendants] ***120** to another Family Defendant, either directly or indirectly" without providing any sort of estimate of the amount of the purported Subsequent Transfer, or when or how such Transfer occurred. Compl. ¶ 167. While the Complaint's failure to indicate specific amounts does not in and of itself warrant dismissal of the Subsequent Transfer claims, *K.E.R. U. Realty Corp.*, 379 B.R. at 30–31 (finding a subsequent transfer claim adequately pled where the complaint stated, "at least tens of millions of dollars were fraudulently diverted from [debtor] to [initial transferees] ... [and] a portion of these fraudulently diverted funds was transferred from the [initial transferees] to, or for the benefit of, the [subsequent transferees]"), its failure to provide even a modicum of specificity with respect to the Subsequent Transfers so as to put the Defendants on notice as to which ones the Trustee seeks to recover does so warrant. *See Gowan v. Amaranth LLC (In re Dreier LLP)*, No. 10–03493, 2011 WL 2412601, at *11 (Bankr.S.D.N.Y. June 16, 2011).

The *Amaranth* court held similarly vague allegations to be insufficient to sustain a subsequent transfer claim. 452 B.R. 451, 2011 WL 2412601, at *11 ("The only scintilla of evidence put forth by the Trustee is a bald assertion that 'it is likely that Amaranth Partners invested the money DLLP transferred to it pursuant to the Note Fraud to Amaranth LLC'.... The Trustee merely asserts that *'[o]n information and belief,* Amaranth Partners transferred its Transfers to Amaranth LLC.' ") (emphasis in the original). To arrive at this conclusion, the *Amaranth* court distinguished the facts alleged by the trustee in that case from those alleged by this Trustee in *Merkin I* and concluded that in *Merkin I,* "the complaint satisfied the Rule 8(a) pleading requirement because it provided 'fair notice' to the defendants of the claims against them because certain exhibits attached to the complaint indicated the percentage of fees and commissions that the defendants purported to receive on account of the transfers to an initial transferee." *Amaranth,* 452 B.R. at 465 (citing *Merkin I,* 440 B.R. at 270). Indeed, the complaint in *Merkin I* identified the subsequent transfers in predetermined amounts in the Funds' Offering Memoranda, which was attached as an exhibit, and "thus adequately apprises the Merkin Defendants, the alleged recipients of these fees, of which transactions are claimed to be fraudulent and why, when they took place, how they were executed and by whom." 440 B.R. at 270 (internal quotations omitted). No such information is provided here.

Accordingly, Count Ten of the Complaint to recover Subsequent Transfers is dismissed with leave to amend within forty five days.

F. The Trustee has Sufficiently Pled a Basis For Disallowing the Defendants' SIPA Claims

[40][41] The Trustee has sufficiently pled Count Eleven of the Complaint to disallow the Defendants' SIPA claims under section 502(d) of the Code, which states, "the court shall disallow any claim of any entity ... that is a transferee of a [voidable] transfer." 11 U.S.C. § 502(d). The purpose of this section is to "preclude entities that have received voidable transfers from sharing in the distribution of assets unless and until the voidable transfer has been returned to the estate." *In re Mid. Atl. Fund, Inc.*, 60 B.R. 604, 609 (Bankr.S.D.N.Y.1986); *see also In re MacMenamin's Grill Ltd.*, 450 B.R. 414 (Bankr.S.D.N.Y.2011) (recognizing the distinction between "transfer" and "obligation" as relevant to a determination of the applicability of section 502(d)) (citing *In re Asia Global Crossing, Ltd.*, 333 B.R. 199, 204 (Bankr.S.D.N.Y.2005)). The Defendants***121** are allegedly "the recipients of transfers of BLMIS' property which are recoverable" under the Code and SIPA, and those transfers have not been returned to the Trustee. Compl. at ¶ 174 (emphasis added). As a result, the Trustee's claim under section 502(d) of the Code is adequately pled. The Motions to Dismiss Count Eleven of the Complaint are therefore denied.

G. The Trustee Has Adequately Alleged a Claim for Equitable Subordination of the Defendants' SIPA Claims

[42] The Trustee has sufficiently pled Count Twelve of the Complaint to equitably subordinate the Defendants' SIPA claims, pursuant to section 510(c) of the Code, which empowers this Court to "subordinate for the purposes of an allowed interest to all or part of another allowed interest." 11 U.S.C. § 510(c).

[43][44] "To plead equitable subordination successfully, a complaint must contain enough facts to satisfy each part of the following three-part test: (1) that the [Defendants] engaged in inequitable conduct, (2) that the misconduct caused injury to the creditors

or conferred an unfair advantage on the defendant-claimant, and (3) that bestowing the remedy of equitable subordination is not inconsistent with bankruptcy law." *In re Hydrogen, L.L.C.*, 431 B.R. 337, 358 (Bankr.S.D.N.Y.2010) (citing *In re Mobile Steel Co.*, 563 F.2d 692, 700 (5th Cir.1977)). Such subordination is confined to offsetting "specific harm that creditors have suffered on account of the inequitable conduct;" it "is remedial, not penal." *In re SubMicron Sys. Corp.*, 291 B.R. 314, 327–29 (D.Del.2003); *see also Enron Corp. v. Springfield Assocs., L.L.C. (In re Enron Corp.)*, 379 B.R. 425, 434 (S.D.N.Y.2007). Thus, undoing inequality is at the core of 510(c)'s grant of authority. *Societa Internazionale Turismo, S.P.A v. Barr (In re Lockwood)*, 14 B.R. 374, 380–81 (Bankr.E.D.N.Y.1981). ("The fundamental aim of equitable subordination is to undo or offset any inequality in the claim position of a creditor that will produce injustice or unfairness to other creditors in terms of bankruptcy results.") (internal quotations omitted).

The Complaint is replete with allegations that the Defendants have left much to undo. *See* Comp ¶¶ 28–29, 32, 37–39, 43, 45, 47–49, 51–58, 73, 94, 98, 182. As explained in-depth below, the Complaint sufficiently alleges that the Defendants breached their fiduciary duties to BLMIS and those breaches directly harmed the same. *See* Section II.C. *infra; Official Comm. of Unsecured Creditors of the Debtors v. Austin Fin. Servs., Inc., (In re KDI Holdings, Inc.)*, 277 B.R. 493, 511 (Bankr.S.D.N.Y.1999) (observing that the remedy of equitably subordination has been applied in cases, where it was found that the defendants breached their fiduciary duties). It additionally alleges that the Defendants were unjustly enriched at the expense of BLMIS due to their failures to adequately perform these duties. *See* Section II.E. *infra.* These factual allegations set out the Defendants' "inequitable conduct" injurious to creditors, and moreover, these allegations establish that the remedy of equitable subordination in this instance would not be inconsistent with bankruptcy law. *See Adelphia Commc'ns Corp. v. Bank of Am. (In re Adelphia Commc'ns Corp.)*, 365 B.R. 24, 67 (Bankr.S.D.N.Y.2007). Thus, in the event one exists, any allowed interest of the Defendants in the BLMIS SIPA Liquidation should be equitably subordinated. Accordingly, the Motions to Dismiss count twelve of the Complaint are denied.

* * *

*122 For the foregoing reasons, the Motions to Dismiss the Bankruptcy Claims are denied except with regard to the Trustee's Preference claims in Count Two, Actual and Constructive Fraudulent Transfer claims in Counts Three through Nine to the extent stated herein, and Subsequent Transfer claims in Count Ten, with leave to amend the Complaint within forty five days.

II. THE COMMON LAW CLAIMS

Through the Common Law Claims the Trustee seeks to recover damages suffered by BLMIS as a result of the Defendants' failure to perform duties arising from their management roles at BLMIS. To support these Claims, the Complaint alleges that the Defendants were directors, officers, managers, and fiduciaries with broad oversight of BLMIS as a whole, and that their responsibilities included developing and implementing a supervisory system to prevent and report any fraudulent activity occurring within BLMIS. Specifically, according to BLMIS's purported compliance policies, the Defendants were required to "respond to red flags," closely scrutinize "any aberrational activity," and "monitor ... the activities of BLMIS personnel to ensure that the policies and procedures ... [were] being followed." Compl. ¶ 33. The Trustee alleges the Defendants failed to implement and comply with these policies, thereby directly enabling Madoff's Ponzi scheme to continue undetected to the detriment of BLMIS.

Before reaching the merits of the Common Law Claims, the Court must first determine whether the Trustee has standing to assert them, and second, if he does, whether New York General Business Law §§ 352 *et seq.*, commonly referred to as the Martin Act, otherwise preempts him from bringing them. N.Y. Gen. Bus. Law §§ 352 *et seq.* (McKinney 2010). As set forth below in greater detail, this Court finds the Trustee has standing to assert Common Law Claims on behalf of the BLMIS estate, and the Martin Act does not preempt him from pursuing them against the Defendants.

A. The Trustee Possesses Standing to Pursue the Common Law Claims on behalf of the BLMIS Estate

[45][46][47] Given the "hybrid" nature of a SIPA liquidation, *In re BLMIS II*, 654 F.3d 229, at 242 n. 10, a SIPA trustee has at least as many powers and

responsibilities as an ordinary bankruptcy trustee under Title 11. *See also* 15 U.S.C. § 78fff–1(a) ("A trustee shall be vested with the same powers and title with respect to the debtor and the property of the debtor, including the same rights to avoid preferences, as a trustee in a case under Title 11."). An ordinary bankruptcy trustee, pursuant to Second Circuit precedent, has standing to assert claims against corporate insiders alleging injury to the debtor. *In re The Mediators, Inc.*, 105 F.3d 822, 826–27 (2d Cir.1997) ("We agree that a bankruptcy trustee, suing on behalf of the debtor under New York law, may pursue an action for breach of fiduciary duty against the debtor's fiduciaries."); *St. Paul Fire and Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688, 702 n. 3 (2d Cir.1989) (finding that "causes of action that could be asserted by the debtor are property of the estate and should be asserted by the trustee...."); *In re Keene Corp.*, 164 B.R. 844, 853 (Bankr.S.D.N.Y.1994) ("Section 720 of New York's Business Corporation law expressly authorizes a corporation or bankruptcy trustee to sue the corporation's officers and directors for breach of fiduciary duty, including misappropriation or diversion of assets...."). The rationale for this is plain: section 541(a)(1) of the Code defines property of the estate as "all ***123** legal or equitable interests of the debtor ... as of the commencement of the case" including the estate's causes of action. *In re Smart World Techs., LLC*, 423 F.3d 166, 175 (2d Cir.2005) (citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n. 9, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983)). It follows, therefore, that the Trustee has standing to assert the Common Law Claims, to the extent these Claims belong to the BLMIS estate. [FN24]

> FN24. The district court in *Picard v. HSBC Bank PLC* held that the Trustee lacks standing—both directly and under theories of bailment, subrogation, assignment or contribution—to assert common law claims against third parties *on behalf of BLMIS customers*. Nos. 11 Civ.763, 11 Civ. 836, 454 B.R. 25, 2011 WL 3200298, at *3 (S.D.N.Y. July 28, 2011). Here, although Common Law Claims appear to have been asserted on behalf of customers and the BLMIS estate, *see, e.g.*, Compl. ¶¶ 182, 184 (alleging breach of fiduciary duty owed to, and damages caused to, "BLMIS and its customers"), the Trustee has since insisted that he "is not suing [the Defendants] on behalf of the firm's customers but on behalf of the firm itself for [the Defendants'] failures to carry out faithfully their duties to BLMIS." Trustee's Supplemental Letter at 2. In light of this supplemental submission, and in accordance with the holding in *HSBC*, this Court need only address the plausibility of the Trustee's Common Law Claims to the extent they are asserted on behalf of the BLMIS estate.

[48][49][50][51][52][53] In *HSBC*, the Trustee, as successor in interest to Madoff and BLMIS, lacked standing under the *Wagoner* rule [FN25] to bring common law fraud claims against the defendants (the "HSBC Defendants"). 454 B.R. at 29. The allegations presented here do not compel the same conclusion. Indeed, the HSBC Defendants were undisputedly third parties and *Wagoner* provides, "a claim *against a third party* for defrauding a corporation accrues to creditors, not to the guilty corporation." 944 F.2d at 114 (emphasis added); *see also In re Verestar, Inc.*, 343 B.R. 444, 479 (Bankr.S.D.N.Y.2006) ("[A] plaintiff acting on behalf of a debtor cannot sue *an outside professional or other third party* for damages for which the corporation itself can be held responsible.") (emphasis added). By contrast, the Defendants in the instant proceeding are alleged to be fiduciaries and insiders of BLMIS, and it is well established that the *Wagoner* and *in pari delicto* rules do "not apply to actions of fiduciaries who are insiders in the sense that they either are on the board or in management, *or in some other way control the corporation.*" *In re Optimal U.S. Litg.*, No. 10 Civ. 4095, 2011 WL 3809909, at *9 (S.D.N.Y. Aug. 26, 2011) (internal quotations omitted)(emphasis in the original); *Winnick*, 2006 WL 2212776, at *15 ("Courts have held that the Wagoner and 'in pari delicto' rules do not apply to claims against corporate insiders for breach of their fiduciary duties.") (citing *In re the Mediators, Inc.*, 105 F.3d at 826–27); *In re Grumman Olson Indus., Inc.*, 329 B.R. 411, 425 (Bankr.S.D.N.Y.2005) ("[T]he *Wagoner* Rule does not bar claims against corporate fiduciaries...."); *Tese–Milner v. Beeler (In re Hampton Hotel Investors, L.P.)*, 289 B.R. 563, 577 n. 23 (Bankr.S.D.N.Y.2003) ("The *Wagoner* Rule only deals with claims against third parties. It does not proscribe actions against insiders for breach of fiduciary duty, which are ***124** properly claims of the trustee."); *Official Committee of Unsecured Creditors v. Austin Fin. Serv., Inc. (In re KDI Holdings, Inc.)*, 277 B.R. 493, 518 (Bankr.S.D.N.Y.1999) ("[T]he *in pari delicto* doctrine is inapplicable where a cause of

action is brought against an insider.").[FN26] Consequently, to the extent that the Trustee has established the Defendants' positions at BLMIS rendered them insiders and fiduciaries, he is not barred by *Wagoner* or *in pari delicto* from asserting claims against them on behalf of BLMIS.

FN25. The *Wagoner* rule "deprive[s] a trustee from even having standing to bring in federal court a common law claim that is clearly defeated by the doctrine of *in pari delicto*." 454 B.R. at 29 (citing *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir.1991)). Under New York law, the doctrine of *in pari delicto* operates as an affirmative defense whereby a wrongdoer, or a plaintiff asserting a claim on behalf of a wrongdoer, is generally barred from recovering against a commensurate wrongdoer. *Kirschner v. KPMG LLP*, 15 N.Y.3d 446, 912 N.Y.S.2d 508, 938 N.E.2d 941, 958–59 (2010).

FN26. The rationale for the insider exception to the *in pari delicto* doctrine stems from the agency principles upon which the doctrine is premised; a corporate insider, whose wrongdoing is typically imputed to the corporation, should not be permitted to use that wrongdoing as a shield to prevent the corporation from recovering against him. *Official Comm. of Unsecured Creditors v. Shapiro (In re Walnut Leasing Co.)*, No. 99–526, 1999 WL 729267, at *5 (E.D.Pa. Sept. 8, 1999) ("Vis-à-vis their corporations, insiders cannot avoid the consequences of their own handiwork."). Indeed, a corporation "is represented by its officers and agents," and "all [of their] corporate acts—including fraudulent ones—are subject to the presumption of imputation" to the corporation. *Kirschner*, 912 N.Y.S.2d 508, 938 N.E.2d at 951(internal quotations omitted); *see also In re Oakwood Homes Corp.*, 356 Fed.Appx. 622, 627 n. 4 (3rd Cir.2009) ("The exception derives from the fact that corporations act through their directors, officers, and controlling stockholders."); *Granite Partners, L.P. v. Bear, Stearns & Co. Inc. (In re Granite Partners, L.P.)*, 194 B.R. 318, 332 (Bankr.S.D.N.Y.1996) ("*In pari delicto* ... does not apply to corporate insiders or partners. Otherwise, a trustee could never sue the debtor's insiders on account of their own wrongdoing.").

[54][55] General partners, sole shareholders, and sole decision makers are "insiders" or fiduciaries in the context of the *in pari delicto* doctrine under New York common law. *In re Adelphia Communs. Corp.*, 322 B.R. 509, 529 n. 18 (Bankr.S.D.N.Y.2005) (holding general partner was insider who could not use *in pari delicto* defense); *Granite Partners, L.P. v. Bear, Stearns & Co., Inc.*, 17 F.Supp.2d 275, 308 (S.D.N.Y.1998) (holding sole voting shareholders and sole general partners are insiders whose wrongdoing is imputed to plaintiff). "No reported authority suggests an *officer or director* can assert the defense of *in pari delicto* " to escape liability to the corporation on whose behalf he or she acted. *In re Walnut Leasing Co.*, 1999 WL 729267, at *5, n. 12 (emphasis added). Even a third-party professional, typically the quintessential outsider, may surrender an *in pari delicto* defense where it exerts sufficient domination and control over the guilty corporation to render itself an insider. *See, e.g., In re KDI Holdings, Inc.*, 277 B.R. at 518 ("[T]he Committee has alleged sufficient facts with regard to Austin's and Schneider's insider status through domination and control to render the *in pari delicto* defense inapplicable in this case"); *see also In re IDI Constr. Co., Inc.*, 345 B.R. 60, 67 (Bankr.S.D.N.Y.2006) (holding that *in pari delicto* did not bar a claim against a consultant involved in the fraud).

The Complaint alleges that the Defendants were senior officers, directors, and compliance managers of BLMIS. Comp. ¶¶ 28–36. Peter, an experienced and licensed investment and legal professional, held the title of Senior Managing Director and Chief Compliance Officer of BLMIS and was designated principal responsible for supervising BLMIS personnel in the absence of Madoff himself. Comp. ¶¶ 37–42. Mark and Andrew, also investment professionals, held titles of Co–Directors of Trading at BLMIS, and were designated as personally responsible for carrying out the Firm's policy in Madoff's absence. Comp. ¶¶ 47–51. Shana was in-house Counsel and Compliance Director of ***125** BLMIS and the sole custodian for most BLMIS compliance documents and regulatory materials; she was responsible for overseeing compliance with firm policy as well as investigating

and correcting reported aberrational activity. Comp. ¶¶ 43–46. These and other similar allegations set forth in Complaint suffice to establish, for relevant purposes, that the Defendants were fiduciaries and insiders of BLMIS. *See* Kirschner, 912 N.Y.S.2d 508, 938 N.E.2d at 951.

Accordingly, the *Wagoner* rule and the *in pari delicto doctrine* do not bar the Trustee from asserting Common Law Claims on behalf of BLMIS against the Defendants.

B. The Trustee's Common Law Claims are Not Preempted by New York's Martin Act

[56] For the better part of a century, the Martin Act has empowered the New York State Attorney General to take action against fraudulent practices involving securities. *See* Anwar, 728 F.Supp.2d at 359. When originally enacted in 1921, the Martin Act granted the Attorney General the power "to bring actions to enjoin imminent frauds" but "failed to address fraudulent activities that had been already completed." *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgt. Inc.*, 80 A.D.3d 293, 915 N.Y.S.2d 7, 11 (N.Y.App.Div.2010). This changed, however, in 1955 with the enactment of section 352–c, which authorizes the Attorney General to institute criminal and civil proceedings, predicated "on mere conduct, absent any proof of scienter or criminal intent." *Id.* As the Martin Act currently stands, these statutory powers remain available under section 352–c, provided, however that the Attorney General limits all Martin Act prosecutions to:

> (a) Any fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale;
>
> (b) Any promise or representation as to the future which is beyond reasonable expectation or unwarranted by existing circumstances;
>
> (c) Any representation or statement which is false, where the person who made such representation or statement: (i) knew the truth; or (ii) with reasonable effort could have known the truth; or (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representations or statements made.
>
> N.Y. Gen. Bus. Law § 352–c (McKinney 2010).

The Common Law Claims arise from the Defendants' alleged derelictions of internal management duties and misuses of company funds unrelated to any specific investment accounts under management or any particular investment advice or decision. *See* Compl. ¶¶ 28–36, 42, 46, 49, 52–58. Thus, absent allegations of one of the types of conduct prohibited by the Martin Act—fraud, deception, unreasonable future promise, or false representation related to the sale of security—these Claims do not implicate its plain language. *See Assured Guar. (UK) Ltd.*, 915 N.Y.S.2d at 12 ("The plain language of the Martin Act does not explicitly preempt all common-law claims.").

The Defendants nevertheless contend that if the Common Law Claims were permitted to go forward, the policy underlying the Martin Act would be undermined or otherwise compromised. They explain that the Martin Act grants the New York Attorney General exclusive power over all claims arising out of securities fraud, and thus "[t]o allow private plaintiffs to bring common law claims related to the Martin ***126** Act would detract from the New York State Attorney's exclusive enforcement power over the Act." Mark and Andrew Mot. at 12. To support their position, the Defendants rely on decisions issued by federal courts in the Southern District of New York that have held that the Martin Act precludes a private right of action for any non-fraud tort claim that arises in the securities context and lacks a scienter element. *See, e.g., In re Beacon Assoc.'s Litig.*, 745 F.Supp.2d 386, 431 (S.D.N.Y.2010); *Abbey v. 3F Therapeutics, Inc.*, No. 06 Civ. 409, 2009 WL 4333819, at *14 (S.D.N.Y. Dec. 2, 2009); *Pro Bono Invs., Inc. v. Gerry*, No. 03 Civ. 4347, 2005 WL 2429787, at *16 (S.D.N.Y. Sept. 30, 2005); *Sedona Corp. v. Ladenburg Thalmann & Co., Inc.*, No. 03 Civ. 3120, 2005 WL 1902780, at *21–23 (S.D.N.Y. Aug. 9, 2005). These decisions, however, represent only one side of an ongoing debate among federal and state courts in New York over the Martin Act's preemptive effect. The other side of the debate, which the New York Attorney General has joined,[FN27] holds that neither the plain language of the Martin Act nor its legislative intent supports preemption of all non-fraud common law claims. *See, e.g., Anwar*, 728 F.Supp.2d at 365; *Assured Guar. (U.K.) Ltd.*, 915 N.Y.S.2d at 15; *CMMF, LLC v. J.P. Morgan Inv. Mgt. Inc.*, 78 A.D.3d 562, 915 N.Y.S.2d 2, 6 (N.Y.App.Div.2010);

Caboara v. Babylon Cove Dev., 54 A.D.3d 79, 862 N.Y.S.2d 535, 538–39 (N.Y.App.Div.2008).

> FN27. In at least two separate amicus curiae briefs filed in New York courts, the Attorney General has taken the position that the Martin Act does not preempt any private right of action in the investment securities context. Brief for the Attorney General of the State of New York as Amicus Curiae, *CMMF, LLC v. J.P. Morgan Inv. Mgt. Inc.*, 78 A.D.3d 562, 915 N.Y.S.2d 2 (N.Y.App.Div.2010) (No. 601924/09); Brief for the Attorney General of the State of New York as Amicus Curiae, *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgt. Inc.*, 80 A.D.3d 293, 915 N.Y.S.2d 7 (N.Y.App.Div.2010)(No. 603755/08).

Here, because "the Attorney General has, by operation of statute, no enforcement power," it is "difficult to see how permitting a common law claim to go forward would interfere with the state's legislature's enforcement mechanism." *Nanopierce Techs., Inc. v. Southridge Capital Mgmt. LLC*, No. 02 Civ. 0767, 2003 WL 22052894, at *5 (S.D.N.Y. Sept. 2, 2003) *see also Hecht v. Andover Assocs. Mgmt. Corp.*, 910 N.Y.S.2d 405, 2010 WL 1254546, *9 (N.Y.Sup.2010) (finding that fiduciary duty and other common law claims arising from Madoff-related matters were not based on the type of misconduct that the Attorney General prosecutes as Martin Act violations, and thus were not preempted by the Martin Act). Indeed, the Common Law Claims are not based on fraud, deception, unreasonable future promise, or false representation, but instead on allegations that the Defendants failed to carry out their compliance and supervisory responsibilities and improperly used company funds for personal use. Similar circumstances arose in *Louros v. Kreicas*, 367 F.Supp.2d 572, 595–96 (S.D.N.Y.2005), which involved various common law claims against an investment advisor who had discretionary authority over the investments of his client. There, the court determined that the claims for breach of fiduciary duty were based on "failures to manage Lourous's account properly and to keep him informed" and "do[ ] not come within the purview of the Martin Act." *Id.* Specifically, in sustaining the breach of fiduciary duty claim, the court reasoned the "reach of the [Martin] Act" cannot be "unlimited" and thus "[a] claim of breach of duty that involves securities but does not allege any kind of dishonesty or deception implicates neither the plain language ***127** of the statute nor its policies." *Id.*; *see also Hecht*, 910 N.Y.S.2d 405, *9 (same).

The Motions to Dismiss on Martin Act preemption grounds are therefore denied.

* * *

Having determined that the Martin Act and the *Wagoner* Rule do not affect the Trustee's ability to assert the Common Law Claims, this Court now turns to whether these Claims survive Rule 12(b)(6) scrutiny. The Trustee's Common Law Claims for breach of fiduciary duty, negligence, unjust enrichment, constructive trust, and accounting in Counts Thirteen, Sixteen, Fifteen, Seventeen, and Eighteen of the Complaint, respectively, survive Rule 12(b) scrutiny. The Trustee's claim for conversion in Count Fourteen of the Complaint, however, is dismissed with leave to amend within forty five days.

C. The Trustee's Claims for Breach of Fiduciary Duty and Negligence are Adequately Pled

[57][58] Under New York law, "[t]he elements of a cause of action to recover damages for breach of fiduciary duty are (1) the existence of a fiduciary relationship, (2) misconduct by the defendant, and (3) damages directly caused by the defendant's misconduct." *Rut v. Young Adult Inst., Inc.*, 74 A.D.3d 776, 901 N.Y.S.2d 715, 717 (N.Y.App.Div.2010). Similarly, the elements of a claim for negligence under New York law are: "(i) a duty owed to the plaintiff by the defendants; (ii) breach of that duty; and (iii) injury substantially caused by that breach." *Lombard v. Booz–Allen & Hamilton, Inc.*, 280 F.3d 209, 215 (2d Cir.2002).

[59] The Complaint alleges that each Defendant's relationship with BLMIS was fiduciary in nature since it was "characterized by trust and reliance" as well as an "assumption of control and responsibility for the affairs of [the firm]." *TP Grp., Inc. v. Wilson*, No. 89 Civ. 2227, 1990 WL 52131, at *3 (S.D.N.Y. Apr. 17, 1990). Peter was BLMIS's CCO, responsible for ensuring that the IA Business had compliance procedures in place to detect any potential fraud. Compl. ¶¶ 37–42. Mark and Andrew were senior managers and supervisors of the firm and its Co–Directors of Trading. Compl. ¶¶ 47–49. Shana was

BLMIS's Compliance Director, as well as compliance counsel and in-house counsel. Compl. ¶¶ 43–46; *see also Andy Warhol Found. for Visual Arts, Inc. v. Hayes (In re Hayes)*, 183 F.3d 162, 168 (2d Cir.1999) (explaining that "the attorney-client relationship entails one of the highest fiduciary duties imposed by law" and includes the duty of "operating competently"). At this stage of the proceedings, the allegations set forth in Complaint are sufficient to establish that a fiduciary relationship existed between the Defendants and BLMIS.[FN28]

> FN28. The precise nature and scope of the fiduciary relationship that each individual Defendant had with BLMIS need not be ascertained at this stage. Indeed, courts applying New York law have consistently held that such a determination is a mixed question of law and fact and cannot always be determined on a motion to dismiss. *See Am. Int'l Group, Inc. v. Greenberg*, 23 Misc.3d 278, 877 N.Y.S.2d 614 (N.Y.Sup.Ct.2008) (denying a motion to dismiss on the grounds that "factual issues concerning the precise nature and scope of the [fiduciary] relationship ... undoubtedly must be explored"); *see also Nisselson v. Ford Motor Credit Co. (In re Monahan Ford Corp. of Flushing)*, 340 B.R. 1, 41 (Bankr.E.D.N.Y.2006) (explaining that "whether fiduciary duties actually arose between the parties is a question of fact not properly addressed" at the motion to dismiss stage).

[60] Just as the Trustee has sufficiently alleged the existence of a fiduciary relationship between the Defendants and BLMIS, so has the Trustee plausibly alleged***128** that the Defendants' conduct, whether intentional or negligent, constituted a breach of that relationship. Indeed, a plausible inference can be drawn from the facts alleged that the Defendants breached their duties, expressly set forth in BLMIS compliance manuals and mandated by applicable securities laws and regulations, to properly supervise BLMIS operations. For example, Peter is alleged to have regularly failed to perform those duties expressly delegated to him in BLMIS's internal compliance manuals including, but not limited to, "verify[ing] compliance with [BLMIS's allocation and trade aggregation] policies and procedures" and "conduct[ing] periodic reviews of allocation records in order to verify that order allocations are being made in accordance with [BLMIS's] ... procedures." Compl. ¶ 42. Shana similarly failed to monitor BLMIS's compliance with federal securities laws and regulations and corresponding FINRA rules and regulations, even as she assisted her father, Peter, in drafting the annual review of the IA Business compliance program. Compl. ¶ 43, 46. While Shana argues that her duties applied to discreet, legitimate operations of BLMIS, the Complaint provides an email in which she concedes that "the Compliance Departments' [sic] monitoring and oversight of compliance issues extends to all areas of the firm's business." Compl. ¶ 45. The Complaint alleges that Andrew and Mark, FINRA-registered securities principals, played roles in the IA business at various times and, upon information and belief, had "direct, investment related contacts and communications with investors in the IA business." Compl. ¶ 49. Peter and Andrew were licensed options principals and were correspondingly responsible for monitoring and approving the options and transactions of the firm. Compl. ¶¶ 47–49. Additionally, in violation of BLMIS's Anti–Money Laundering compliance program, the Defendants failed to investigate or detect suspicious transfers of BLMIS funds to MSIL, even though Mark, Andrew, and Peter were all directors of MSIL.[FN29]

> FN29. Bernard Madoff and Frank DiPascali, a former BLMIS employee, have pled guilty to money laundering charges arising from these transactions.

[61] The Second Circuit's opinion in *Gully v. National Credit Union Administration Board* illustrates how the Defendants' derelictions of their compliance and supervisory duties constitute breaches notwithstanding Madoff's confessed masterminding of the fraud. 341 F.3d 155, 159 (2d Cir.2003). In *Gully*, a manager of a credit union was accused of breach of fiduciary duty for failing to monitor or stop her father, the "dominant figure" at the union, from incurring personal charges on its credit card. *Id.* In finding that the manager "in effect, participated in h[er father's] scheme," the Second Circuit determined that her not doing anything to correct or prevent misconduct and failure to exercise reasonable diligence was "particularly egregious," given her conflict of interest and that she was the only one to police her own father. *Id.* at 165–66. The Second Circuit's reasoning in

Gully is in line with longstanding New York precedent holding fiduciaries to a standard "stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is ... the standard of behavior." *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545 (1928). Fiduciary duties include discharging corporate responsibilities "in good faith and with conscientious fairness, morality and honesty in purpose" and displaying "good and prudent management of the corporation." ***129***Alpert v. 28 Williams St. Corp.*, 63 N.Y.2d 557, 569, 483 N.Y.S.2d 667, 473 N.E.2d 19 (1984) (internal quotations omitted).

[62][63] With that in mind, the Defendants may not escape liability by pointing to Madoff's fraudulent undertakings. Put another way, Madoff's fraudulent activities do not constitute a supervening cause that severs the causal link between the Defendants' above-mentioned breaches and the foreseeable resulting harm to BLMIS. More to the point, "when the intervening, intentional act of another is itself the foreseeable harm that shapes the duty imposed, the defendant who fails to guard against such conduct will not be relieved of liability when that act occurs." *Kush v. City of Buffalo*, 59 N.Y.2d 26, 33, 462 N.Y.S.2d 831, 449 N.E.2d 725 (1983); *see also Derdiarian v. Felix Contracting Corp.*, 51 N.Y.2d 308, 316, 434 N.Y.S.2d 166, 414 N.E.2d 666 (1980) ("[A]n intervening act may not serve as a superseding cause, and relieve an actor of responsibility, where the risk of the intervening act occurring is the very same risk which renders the actor negligent."). Indeed, of all the possible parties to uncover or prevent the fraud, the Defendants were those best situated, and in fact obligated, to do so. Yet, on the basis of the facts alleged, the Defendants shirked their compliance and supervisory duties, engaged in improper personal use of BLMIS funds, and consequently impoverished BLMIS while permitting its descent towards its eventual demise. As such, the Trustee has adequately stated claims for breach of fiduciary duty and negligence against the Defendants.

i. Punitive Damages for Negligence and Breach of Fiduciary Duty Claims

[64] For his negligence and breach of fiduciary duty claims, the Trustee asserts that the Defendants' "conscious, willful, wanton, and malicious conduct entitles [him], on behalf of BLMIS and its creditors, to an award of punitive damages in an amount to be determined at trial." Comp ¶¶ 187, 205. For the following reasons, the Trustee's pursuit of punitive damages against the Defendants cannot be dismissed at this early stage of the case.

[65][66][67][68] Under New York law, punitive damages serve the dual purposes of punishing the offending party while deterring similar conduct by others. *See Ross v. Louise Wise Servs., Inc.*, 28 A.D.3d 272, 812 N.Y.S.2d 325, 331 (N.Y.App.Div.2006). To be liable for punitive damages in tort causes of action, a defendant's actions must "constitute willful or wanton negligence or recklessness." *Gruber v. Craig*, 208 A.D.2d 900, 618 N.Y.S.2d 84, 85 (N.Y.App.Div.1994) (internal quotations omitted). Acts are wanton and reckless when done in a manner "showing heedlessness and an utter disregard for the rights and safety of others." *Id.* The decision to award punitive damages "reside[s] in the sound discretion of the original trier of facts." *Louise Wise Servs., Inc.*, 812 N.Y.S.2d at 331 (internal quotations omitted).

The Trustee has sufficiently alleged that the acts and omissions of the Defendants were performed under circumstances showing "heedlessness and an utter disregard" for the rights or interests of BLMIS and, ultimately, all those who foreseeably relied upon its professed integrity. As discussed extensively above, the Trustee has been unable to identify any meaningful supervision of BLMIS by the Defendants. *See, e.g.*, Compl. ¶ 47. These alleged failures to adequately fulfill their jobs were not, as Mark and Andrew contend, mere "passive shortcomings" regarding their compliance duties. Mark and Andrew Mot. at 45. Rather, the Defendants spent every day for over twenty years in the ***130** offices of the firm where the Ponzi scheme occurred, allegedly ignoring numerous red flags and irregularities at BLMIS in order to enrich themselves and their outside business ventures at the expense of BLMIS. *See* Compl. ¶¶ 58, 62, 74, 84, 85, 94. These failures therefore may well be considered wanton and malicious conduct under the circumstances. Thus, it cannot be "conclusively determined at this stage of the litigation ... that the wrongful conduct alleged is not sufficiently egregious to warrant the imposition of punitive damages." *D'Amour v. Ohrenstein & Brown, LLP*, No. 601418/06, 2007 WL 4126386, at *20 (N.Y.Sup.Ct. Aug. 13, 2007).

D. The Trustee Has Adequately Pled Claims for an Accounting of Funds Allegedly Diverted from BLMIS

[69] The Trustee has sufficiently alleged Count Eighteen of the Complaint, which states that in order "to compensate BLMIS for the amount of monies the [Defendants] diverted from BLMIS for their own benefit, it is necessary for the [Defendants] to provide an accounting of any transfer of funds, assets or property received from BLMIS." Compl. ¶ 214.

[70][71] Under New York law, an accounting is a cause of action that seeks "an adjustment of the accounts of the parties and a rendering of a judgment for the balance ascertained to be due." *DiTolla v. Doral Dental IPA of New York, LLC*, 469 F.3d 271, 275 (2d Cir.2006) (internal quotations omitted). Its purpose is to "help sort out what assets are involved [and] enable the parties to meaningfully pursue their respective claims concerning their private or business arrangement." *Wesselmann v. Int'l. Images*, 259 A.D.2d 448, 687 N.Y.S.2d 339 (N.Y.App.Div.1999) (finding that where the parties shared a close working relationship, an accounting is appropriate to determine what assets are involved). It is not necessary to "identify a particular asset or fund of money in the defendant's possession." *DiTolla*, 469 F.3d at 275 (internal quotations omitted). But it is necessary to establish the "existence of a confidential or fiduciary relationship and a breach of the duty imposed by that relationship respecting property in which the party seeking the accounting has an interest." *Palazzo v. Palazzo*, 121 A.D.2d 261, 503 N.Y.S.2d 381 (N.Y.App.Div.1986); *see Akkaya v. Prime Time Transp., Inc.*, 45 A.D.3d 616, 845 N.Y.S.2d 827, 828 (N.Y.App.Div.2007); 1 N.Y. Jur.2d *Accounts and Accounting* § 34 (2011) (finding a fiduciary relationship between the parties and wrongdoing by the defendant to be "essential elements of an equity complaint where an accounting is demanded").

[72] The Complaint states a claim for an accounting because it sufficiently alleges the Defendants had a fiduciary relationship with BLMIS and they breached their duties imposed by that relationship regarding the property in which the Trustee has an interest. *See Stratton Oakmont, Inc.*, 234 B.R. at 335. As explained above, the Complaint sufficiently alleges that the Defendants breached their fiduciary duties to BLMIS and diverted BLMIS assets for their own benefit. *See* Comp ¶¶ 28–29, 32, 37–39, 43, 45, 47–49, 51–58, 73, 94, 98, 182. One instance where an accounting is particularly appropriate is with regard to the BLMIS funds allegedly used to pay the Defendants' personal expenses. Comp ¶¶ 73, 84, 94, 98. Under these circumstances, an accounting would "help sort out what assets are involved" and determine the Defendants' disposition, if any, of BLMIS property, compel them to disgorge improper gains, and obtain information in aid of recovering their withdrawals of fictitious***131** profits. *Wesselmann*, 687 N.Y.S.2d at 341.[FN30]

FN30. The Defendants contend the Trustee should be limited solely to discovery in order to determine the amount of money at issue. A bankruptcy trustee is permitted, however, to pursue an accounting action to determine the extent of self-dealing by a corporation's senior executives and the value of the assets of the debtor corporation. *See In re Colonial Mortgage Bankers Corp.*, 1989 Bankr.LEXIS 2783, *18 (Bankr.D.P.R. Apr. 12, 1989) (noting that "one of the purposes of an accounting is to separate the commingled funds and assets of the defendants from the ones of the estate," the court enjoined the defendants "from transferring any personal assets until the [trustee's] accounting is performed").

E. The Trustee's Unjust Enrichment and Constructive Fraud Claims Are Adequately Pled

[73] Count Fifteen of the Complaint states that the Defendants benefited from the receipt of money from BLMIS at its expense, without adequately compensating or providing value to it, and that "[e]quity and good conscience require full restitution of the monies received by [Defendants] from BLMIS." Compl. ¶¶ 195–96. Count Seventeen further states that "because of past unjust enrichment of the [Defendants], the Trustee is entitled to the imposition of a constructive trust with respect to any transfer of funds, assets, or property from BLMIS as well as any profits received by the [Defendants] in the past or on a going forward basis in connection with BLMIS." Compl. ¶ 209. Both Counts Fifteen and Seventeen of the Complaint pass muster under Rule 12(b) because the Trustee has alleged enough facts in the Complaint to sustain his claims for unjust enrichment and the imposition of a constructive trust against the Defendants.

[74][75][76][77][78] New York courts have long recognized that "a court of equity in decreeing a constructive trust is bound by no yielding formula. The equity of the transaction must shape the measure of relief." *Beatty v. Guggenheim Exploration Co.*, 225 N.Y. 380, 386, 122 N.E. 378 (1919); *see also Counihan*, 194 F.3d at 362 (same).[FN31] New York courts insist upon "a showing that property is held under circumstances that render unconscionable and inequitable the continued holding of that property and that the remedy is essential to prevent unjust enrichment." *Counihan v. Allstate Ins. Co.*, 194 F.3d 357, 362 (2d Cir.1999); *see also Golden Budha Corp. v. Canadian Land Co. of Am., N.V.*, 931 F.2d 196, 202 (2d Cir.1991). An unjust enrichment claim brought under New York law must be predicated on factual allegations that the defendant was enriched at the plaintiff's expense, and that "it is against equity and good conscience to permit [the defendant] to retain what is sought to be recovered." *Mandarin Trading Ltd. v. Wildenstein*, 16 N.Y.3d 173, 182, 919 N.Y.S.2d 465, 944 N.E.2d 1104 (2011). To prove such a claim, it is necessary to show that "one party has received money or a benefit at the expense of another." *See* ***132***Amusement Indus., Inc. v. Stern*, No. 07–11586, 2010 WL 445906, at *21 (S.D.N.Y. Mar.1, 2010) (internal citations omitted). The transaction must be "unjust." *McGrath v. Hilding*, 41 N.Y.2d 625, 627, 394 N.Y.S.2d 603, 363 N.E.2d 328 (1977). But, "whether there is unjust enrichment may not be determined from a limited inquiry confined to an isolated transaction. It must be a realistic determination based on a broad view of the human setting involved." *Id.*

> FN31. In determining whether to impose a constructive trust under New York law, courts consider four factors: (1) a confidential or fiduciary relationship; (2) a promise, express or implied; (3) a transfer made in reliance on that promise; and (4) unjust enrichment. *Sharp v. Kosmalski*, 40 N.Y.2d 119, 386 N.Y.S.2d 72, 351 N.E.2d 721, 723(1976). However, "these factors are merely useful guides and are not talismanic." *Coco v. Coco*, 107 A.D.2d 21, 485 N.Y.S.2d 286 (N.Y.App.Div.1985) (internal quotations omitted); *see also In re Koreag*, 961 F.2d at 352 ("Although these factors provide important guideposts, the constructive trust doctrine is equitable in nature and not to be rigidly limited.") (internal quotations omitted); *Palazzo*, 503 N.Y.S.2d at 383–84 ("[T]he power of equity to employ a constructive trust to reach a just result is not strictly limited by the conditions set forth in *Sharp v. Kosmalski*.").

Here, the Defendants allegedly misappropriated BLMIS's funds for improper personal uses such as funding personal business ventures and homes. Compl. ¶¶ 66–99. The Defendants also allegedly failed to perform legal compliance and supervisory responsibilities they were legally obligated to perform at BLMIS, but nevertheless received astronomical compensation from the same. Compl. ¶¶ 28, 37, 43, 57, 58, 64. These and other similar facts alleged in the Complaint, when viewed in conjunction with the relevant precedent, sufficiently establish that the Defendants ended up with BLMIS's funds that they should not possess, and more to point, in possessing them, the Defendants unjustly enriched themselves at the expense of BLMIS.

[79][80] As the Trustee has sufficiently alleged that the Defendants are unjustly enriched by property rightfully belonging to BLMIS, the Trustee has adequately pled the requisite equitable basis for the imposition of a constructive trust. *Simonds v. Simonds*, 45 N.Y.2d 233, 242, 408 N.Y.S.2d 359, 380 N.E.2d 189 (1978) ("[T]he purpose of a constructive trust is the prevention of unjust enrichment."). Contrary to the Defendants' arguments that a constructive trust can "wreak havoc" with the Code, *see* Mark and Andrew Mot. p. 21 n. 10, this Court's conclusion squares with Second Circuit precedent that counsels against freely imposing constructive trusts in bankruptcy proceedings. *See In re Flanagan*, 503 F.3d 171, 182 (2d. Cir.2007); *Superintendent of Ins. v. Ochs (In re First Central Fin. Corp.)*, 377 F.3d 209, 217 (2d Cir.2004). As the Second Circuit recently explained,

> The effect of a constructive trust in bankruptcy is profound. While the bankrupt estate is defined very broadly under § 541(a)(1) of the Bankruptcy Code to include all legal or equitable interests of the debtor, any property that the debtor holds in constructive trust for another is excluded from the estate pursuant to § 541(d) ... A constructive trust thus places its beneficiary ahead of other creditors with respect to the trust *res*.

In re Flanagan, 503 F.3d at 182. Simply put, "the effect of constructive trust in bankruptcy is to take property out of the debtor's estate.... This type of privileging of one unsecured claim over another clearly thwarts the principle of ratable distribution underlying the Bankruptcy Code." *Id.*; *see also In re First Central*, 377 F.3d at 217 ("By creating a separate allocation mechanism outside the scope of the bankruptcy system ... the constructive trust doctrine can wreak ... havoc with the priority system ordained by the Bankruptcy Code."). It follows, therefore, that these concerns only apply in cases where the property in question is held by the estate, and is set to be equitably distributed among general unsecured creditors, which is patently not the case here. *In re Flanagan*, 503 F.3d at 182 ("It is ... not the debtor who generally bears the burden of a constructive trust in bankruptcy, but the debtor's general creditors."). In the pending matter, where the property in question is not possessed by the Trustee but rather by the Defendants, the same threat does not exist, and thus imposing the constructive trust to prevent each Defendant's unjust enrichment at the expense of BLMIS does not clash with the underlying property principles of equitable distribution under the Code or under SIPA.

***133** Thus, for the aforementioned reasons, the Motions to Dismiss Counts Fifteen and Seventeen of the Complaint are denied.

F. The Trustee's Claim for Conversion is Dismissed

[81][82][83][84][85] Under New York law, "[c]onversion is an unauthorized assumption and exercise of the right of ownership over [property] belonging to another to the exclusion of the owner's rights." *Traffix v. Herold*, 269 F.Supp.2d 223, 228 (S.D.N.Y.2003). Specifically, a conversion action requires that the plaintiff has legal ownership or an immediate superior right of possession to the property he seeks to recover and that the defendant exercised an unauthorized dominion over that property "to the alteration of its condition or to the exclusion of the plaintiff's rights." *Ancile Inv. Co. Ltd. v. Archer Daniels Midland Co.*, 784 F.Supp.2d 296, 311 (S.D.N.Y.2011); *Mia Shoes, Inc. v. Republic Factors Corp.*, No 96–CIV–7974, 1997 WL 525401, at *3 (Bankr.S.D.N.Y. Aug. 21, 1997) (same). When money, rather than a chattel, is the property at issue, it "must be specifically identifiable." *Interior by Mussa, Ltd. v. Town of Huntington*, 174 Misc.2d 308, 664 N.Y.S.2d 970, 972 (N.Y.App.Div.1997). In fact, "if the allegedly converted money is incapable of being described or identified in the same manner as a specific chattel ... it is not the proper subject of a conversion." *Id.*

Because the Complaint does not seek a specific amount of money converted from a particular account, but rather "an award of compensatory damages in an amount to be determined at trial" it fails to state a claim for conversion under New York law. Compl. ¶ 192. The Complaint asserts vague, unsubstantiated allegations that "BLMIS had a possessory right and interest to its assets, including its customers' investment funds," Compl. ¶ 189, and "[t]he Family Defendants converted the investment funds of BLMIS customers when they received money originating from other BLMIS customer accounts in the form of loans, payments, and other transfers. These actions deprived BLMIS and its creditors of the use of this money," Compl. ¶ 190. Such allegations "merely refer[ ] to unspecified monies and assets" and give "no indication of an identifiable fund or otherwise segregated amount, nor ... any description of the alleged transfer or transfers from which the Court could infer a specifically identified fund of money." *Global View Ltd. Venture Capital v. Great Central Basin Exploration, L.L.C.*, 288 F.Supp.2d 473, 480 (S.D.N.Y.2003); *see also Cal Distrib. Inc. v. Cadbury Schweppes Americas Beverages, Inc.*, No. 06 Civ. 0496, 2007 WL 54534 (S.D.N.Y. Jan. 5, 2007). These allegations are inadequate to sustain the Trustee's conversion claim against the Defendants. Thus, Count Fourteen of the Complaint is dismissed with leave to amend within forty five days.

CONCLUSION

For the aforementioned reasons, the Motions to Dismiss are denied except with regard to the Trustee's: (1) Preference claims in Count Two, (2) Actual and Constructive Fraudulent Transfer claims in Count Three through Nine to the extent stated herein, (3) Subsequent Transfer claims in Count Ten, and (4) his conversion claim in Count Fourteen, with leave to amend the Complaint within forty five days consistent with the foregoing determinations.

Thus, to the extent described above, the Motions to Dismiss the Complaint are DENIED in part and GRANTED in part.

IT IS SO ORDERED.

Bkrtcy.S.D.N.Y.,2011.
In re Bernard L. Madoff Inv. Securities LLC
458 B.R. 87, 55 Bankr.Ct.Dec. 139

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