

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

SECURITIES INVESTOR PROTECTION
CORPORATION,

Plaintiff,

v.

BERNARD L. MADOFF INVESTMENT
SECURITIES LLC,

Defendant.

Adv. Pro. No. 08-1789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

In re:

BERNARD L. MADOFF,

Debtor.

Adv. Pro. No. 09-1197 (BRL)

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

Plaintiff,

v.

JEFFRY M. PICOWER, individually and as trustee for
the Picower Foundation, et al.,

Defendants.

District Court Appeal No.
11-CV-1298 (JGK) (KNF)

**BRIEF OF APPELLANT SUSANNE STONE MARSHALL, INDIVIDUALLY AND ON
BEHALF OF A SIMILARLY SITUATED CLASS AND OTHER MADOFF INVESTORS
WHOSE CLAIMS ARE NOT RECOGNIZED BY THE TRUSTEE, IN SUPPORT OF
APPEAL FROM ORDER APPROVING AN AGREEMENT BY AND AMONG THE
TRUSTEE AND VARIOUS PICOWER PARTIES AND ISSUING A PERMANENT
INJUNCTION**

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES	iv
PRELIMINARY STATEMENT	1
STATEMENT OF JURISDICTION.....	4
STATEMENT OF ISSUES PRESENTED ON APPEAL.....	4
STANDARD OF APPELLATE REVIEW.....	5
STATEMENT OF THE CASE.....	5
The Madoff scheme and the SIPA Trustee.....	6
The Trustee’s complaint against the Picower Defendants.....	6
The bankruptcy court’s “net equity” ruling deprived thousands of Madoff victims of any recovery from the Estate.....	7
The Marshall Class Action seeks to represent thousands of Madoff victims who suffered substantial damages, but who will receive nothing from the Estate.....	7
The First Injunction and the First Appeal raise the issue of whether Marshall’s claims “belong to” the Trustee.....	8
The Government’s forfeiture action and the Settlement Agreement between the Trustee and the Picower Defendants.....	10
The Settlement Order and the permanent injunction in favor of the Picower Defendants.....	11
SUMMARY OF ARGUMENT	13
ARGUMENT	15
I. THE COURT ERRED IN ENTERING THE PERMANENT INJUNCTION BECAUSE THE BANKRUPTCY COURT LACKS JURISDICTION TO ORDER A NON-CONSENSUAL RELEASE OF INDEPENDENT CLAIMS AGAINST THE NON-DEBTOR PICOWER DEFENDANTS UNDER ESTABLISHED SECOND CIRCUIT LAW.....	15
A. The Bankruptcy Court Lacks Jurisdiction To Bar Marshall’s Independent Claims Because They Do Not “Belong To” The Trustee, Even If Marshall’s Claims Arise Out Of The Same Facts As The Trustee’s.....	15

1.	The bankruptcy court once again erred in holding that Marshall’s claims against the Picower Defendants “belong to” the Trustee.....	15
2.	The bankruptcy court erred in enjoining Appellants’ claims that do not “belong to” the Trustee and are not property of the Estate.....	18
B.	The Trustee Has Conceded, And The Bankruptcy Court Has Held, That A Section 105 Permanent Injunction For The Benefit Of Non-Debtors Like The Picower Defendants Is “Inappropriate.”	22
II.	THE INJUNCTION VIOLATES THE CONTENT, SCOPE, AND SPECIFICITY REQUIREMENTS OF RULE 65 OF THE FEDERAL RULES OF CIVIL PROCEDURE AND RULE 7065 OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE.....	24
III.	THE PERMANENT INJUNCTION SHOULD BE REVERSED BECAUSE IT WAS NOT SUPPORTED BY ANY EVIDENCE.	25
A.	The Standards For Issuing Permanent Injunctions.	25
B.	The Injunction Was Erroneous Because It Was Not Supported By Sufficient Findings.....	25
IV.	THE SETTLEMENT AGREEMENT IS THE PRODUCT OF JUDICIAL ERROR AND SHOULD BE REVERSED.	27
A.	The Bankruptcy Court Failed To Consider Whether The Settlement Was Fair To Non-Parties Such As Appellants.....	27
B.	The Settlement Is Not Fair To The Thousands Of Madoff Victims In The Marshall Class Because It Gives The Trustee An Improper Preference And Priority To The Picower Defendants’ Assets.....	29
V.	THE BANKRUPTCY COURT ERRED IN DENYING APPELLANTS’ REQUEST FOR DISCOVERY UNDER THE CIRCUMSTANCES OF THIS CASE.	30
	CONCLUSION.....	31

TABLE OF AUTHORITIES

	Page(s)
CASES	
<i>Alleyne v. New York State Educ. Dept.</i> , 516 F.3d 96 (2d Cir. 2008)	25
<i>In re American Hardwoods, Inc.</i> , 885 F.2d 621 (9 th Cir. 1989)	22, 23
<i>In re Aweco, Inc.</i> , 725 F.2d 293 (5 th Cir. 1984)	28, 30
<i>In re Colonial Realty</i> , 980 F.2d 125 (2d Cir. 1992).....	29
<i>In re Combustion Engineering, Inc.</i> , 391 F.3d 190 (3d Cir. 2004).....	21
<i>In re Devon Capital Mgmt.</i> , 261 B.R. 619 (Bankr. W.D. Pa. 2001).....	20
<i>In re Dreier LLP</i> , 2010 WL 1707737 (Bankr. S.D.N.Y. Apr. 28, 2010).....	18
<i>eBay Inc. v. MercExchange, L.L.C.</i> , 547 U.S. 388 (2006).....	25
<i>In re Enivid, Inc.</i> , 364 B.R. 139 (Bankr. D. Mass. 2007)	22
<i>In re First Central Fin. Corp.</i> , 238 B.R. 9 (E.D.N.Y. 1999)	22
<i>Giddens v. D.H. Blair & Co.</i> , 280 B.R. 794 (Bankr. S.D.N.Y. 2002)	16
<i>Gunn v. Univ. Comm. To End War in Vietnam</i> , 399 U.S. 383 (1970)	24
<i>In re Halstead Energy Corp.</i> , 367 F.3d 110 (2d Cir. 2004).....	5
<i>In re Iridium Operating LLC</i> , 478 F.3d 452 (2d Cir. 2007)	5
<i>In re Johns-Manville Corp.</i> , 517 F.3d 52 (2d Cir. 2008) <i>rev'd on other grounds by</i> <i>Travelers Indem. Co. v. Bailey</i> , 129 S. Ct. 2195 (2009).....	passim
<i>Knox v. Salinas</i> , 193 F.3d 123 (2d Cir. 1999).....	25, 26
<i>Lau v. Meddaugh</i> , 229 F. 3d 121 (2d Cir. 2000)	24
<i>In re Lowenschuss</i> , 67 F.3d 1394 (9th Cir. 1995).....	21
<i>Maryland Casualty Co. v. Realty Advisory Bd. on Labor Relations</i> , 107 F.3d 979 (2d Cir.1997)	25
<i>In re Metromedia Fiber Network, Inc.</i> , 416 F.3d 136 (2d Cir. 2005).....	21

<i>In re Mrs. Weinberg’s Kosher Foods, Inc.</i> , 278 B.R. 358 (Bankr. S.D.N.Y. 2002).....	20
<i>In re Park S. Sec., LLC.</i> , 326 B.R. 505 (Bankr. S.D.N.Y. 2005).....	16
<i>Picard v. Cohmad Securities Corp. et al.</i> 443 B.R. 291 (Bankr. S.D.N.Y. Feb. 3, 2011).....	22, 23, 26
<i>Picard v. HSBC Bank PLC</i> , 2011 WL 1544494 (S.D.N.Y. April 25, 2011).....	16, 17, 18
<i>Redington v. Touche Ross & Co.</i> , 592 F.2d 617 (2d Cir. 1978), <i>rev’d on other grounds</i> , 442 U.S. 560 (1979).....	17
<i>Schmidt v. Lessard</i> , 414 U.S. 473 (1974)	24
<i>Securities Investor Protection Corp. v. BDO Seidman, LLP</i> , 49 F. Supp.2d 644 (S.D.N.Y. 1999).....	17
<i>Shearson Lehman Hutton, Inc. v. Wagoner</i> , 944 F.2d 114 (2d Cir. 1991).....	8, 13, 15
<i>Travelers Indem. Co. v. Bailey</i> , 129 S. Ct. 2195 (2009).....	18
<i>U.S. Phillips Corp. v. Iwasaki Elec. Co., Ltd.</i> , 607 F. Supp. 2d 470 (S.D.N.Y. 2009).....	25
<i>In re Western Real Estate Fund, Inc.</i> , 922 F.2d 592 (10th Cir. 1991).....	21
<i>In re Zale Corp.</i> , 62 F.3d 746 (5th Cir.1995)	19, 21
STATUTES & RULES	
11 U.S.C. § 105.....	22, 23
11 U.S.C. § 105(a)	9, 22
11 U.S.C. § 524.....	21
11 U.S.C. § 524(e)	21
15 U.S.C. § 78fff-2(b)	16
28 U.S.C. § 158(a)(1).....	4
Fed. R. Bankr. P. 7065.....	4
Fed. R. Bankr. P. 9019.....	5
Fed. R. Civ. P. 65.....	4
Fed. R. Civ. P. 65(d).....	24, 25

PRELIMINARY STATEMENT

This is an appeal of the bankruptcy court's January 13, 2011 order (the "Settlement Order" [Doc. #43 in Adv. Pro. No. 09-1197 (BRL)]) approving the settlement agreement (the "Settlement Agreement" or "Settlement" [Doc. #25, at Exhibit A in Adv. Pro. No. 09-1197 (BRL)]) between the trustee (the "Trustee") in the liquidation of Bernard L. Madoff Investment Securities LLC ("BLMIS") and the estate of Jeffry Picower, Madoff's co-conspirator, Picower's wife, and 16 of his affiliated entities (the "Picower Defendants"). The Settlement Order is erroneous because it permanently enjoins and forever bars the Appellants' prosecution of claims against the Picower Defendants in which they assert claims that are not property of the bankruptcy estate (the "Estate") and which the Trustee lacks standing to assert. At issue is the right of thousands of defrauded Madoff victims, who will receive nothing from the BLMIS bankruptcy or from the Settlement, to sue the Picower Defendants on state law tort claims that only they have standing to bring.

Susanne Stone Marshall ("Marshall") and the class she represents, as well as other Madoff victims whose claims the Trustee does not recognize ("Appellants"), have asserted state law claims against the Picower Defendants that the Trustee cannot by law assert. Nevertheless, the bankruptcy court has twice enjoined prosecution of these claims. In May 2010, the bankruptcy court enjoined (the "First Injunction" [Doc. #22 in Adv. Pro. No. 10-3114 (BRL)]) Marshall's class action against the Picower Defendants (the "Marshall Class Action") and held that Marshall's claims "belonged to" the Trustee and are, therefore, "*void ab initio.*" Marshall's appeal of that order is now pending in this Court (the "First Appeal"). The bankruptcy court lacked subject matter jurisdiction to enjoin Appellants' claims against the Picower Defendants because their claims do not "belong to" the Trustee, under controlling Second Circuit law.

While the First Appeal was pending, the Trustee entered into the "Settlement Agreement"

under which the Picower Defendants irrevocably and unconditionally forfeited \$7.2 billion to the Trustee. In the Settlement Agreement, the Trustee gratuitously requested, and the bankruptcy court gratuitously granted, a permanent injunction against the prosecution of Appellants' claims. (Settlement Order at 7.) The bankruptcy court's injunction improperly bars Appellants' claims, even though the Trustee does not own them, because they are based on the same fraudulent and criminal conduct as the Trustee's allegations against the Picower Defendants.

The permanent injunction in the Settlement Order should be reversed for the same reasons that the injunction on the First Appeal should be reversed. Appellants' independent tort claims are not property of the Estate and the Trustee lacks standing to assert those claims. Thus, the injunction simply and gratuitously protects Madoff's primary criminal co-conspirator from the claims of his victims. Appellants' claims against the Picower Defendants are not the same as the Trustee's, even if the claims arise out of the same set of facts that gave rise to the Trustee's claims. Therefore, the bankruptcy court lacked subject matter jurisdiction to enjoin these claims. *See In re Johns-Manville Corp.*, 517 F.3d 52 (2d Cir. 2008) *rev'd on other grounds by Travelers Indem. Co. v. Bailey*, 129 S. Ct. 2195 (2009).

Permanent injunctions shielding non-debtor third parties from claims, like the ones entered below, are almost never granted and are permissible only when absolutely necessary to a settlement and where all interested parties have consented. Here, that criterion is not met because the Settlement was not conditioned upon entry of the permanent injunction. On the contrary, the settlement funds were forfeited irrevocably. Indeed, the payment of the settlement funds was not even conditioned upon bankruptcy court approval of the Settlement. The Settlement Agreement provides that all of the provisions therein, "including the [mutual releases] contained in paragraphs 3 and 4 , shall become binding and remain effective and binding on the

parties, and shall remain in full force and effect, *even if no Final 9019 Order ever is entered.*” (Settlement Agreement at 5, ¶6 (emphasis added.)) In fact, the Trustee need only use his “best efforts to obtain the Permanent Injunction,” not actually obtain one. (*Id.* at ¶7.) Moreover, under the Settlement Order, the Trustee has released all claims he may have against the Picower Defendants, which leaves the Trustee with no interest in shielding the Picower Defendants from liability to Appellants. Appellants’ pursuit of their claims against the Picower Defendants can have no impact whatsoever on the Trustee or the Estate.

Finally, the bankruptcy court was required, but failed, to make sufficient evidentiary findings to support of the injunction or the fairness of the settlement to the Appellants. The settlement is fundamentally unfair to the thousands of Madoff victims like Marshall who will receive nothing from the Estate or from the Settlement. Picower has agreed to disgorge a total of \$7.2 billion, which is the precise amount of money he stole from BLMIS investors over a period of 38 years, without interest, penalties, or any accounting for the profits he made on \$7.2 billion over a 38-year period.

The Trustee intends to distribute the \$7.2 billion only to the approximately 2,000 Madoff victims (14%) whose claims he recognizes, *i.e.*, those who did not receive the return of their principal before the Madoff scheme collapsed. None of the forfeited funds will be paid to the thousands of victims, like Marshall, who over a period of decades took out more money than they invested even though these people have suffered billions of dollars of damages as a result of the fraud of Madoff and Picower.

The Trustee acknowledged that he may never have been able to recover more than \$2.4 billion from the Picower Defendants in bona fide litigation of his fraudulent transfer claims. Yet the bankruptcy court has approved a much larger settlement, presumably in return for the

improper injunction. The Trustee cannot appropriate Appellants' claims against the Picower Defendants as a matter of law, but the Settlement permits him to do so by taking funds that should be available for recovery to Appellants on their personal claims.

STATEMENT OF JURISDICTION

This Court has jurisdiction to hear this appeal pursuant to 28 U.S.C. § 158(a)(1). The Settlement Order is a final order and subject to appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF ISSUES PRESENTED ON APPEAL

1. Whether the bankruptcy court lacked subject matter jurisdiction to enjoin Appellants from pursuing their personal claims against non-debtors that are not property of the Estate.

2. Whether the bankruptcy court erred in entering the permanent injunction in the Settlement Order:

- a. Where the injunction failed to (and could not) identify any irreparable injury that would occur in the absence of the permanent injunction;
- b. where the permanent injunction was not necessary for a debtor's reorganization;
- c. Where Appellants' claims against third parties that are purported to be permanently enjoined are not property of the estate and so, no estate property is at issue; and
- d. Where the claims are against third parties whom the estate has fully released of all claims.

3. Whether the Settlement Order failed to satisfy the requirements of Federal Rule of Civil Procedure 65 and Rule 7065 of the Federal Rules of Bankruptcy Procedure as to scope, content, and specificity, thereby rendering the injunction unenforceable.

4. Whether the bankruptcy court erred in approving and entering the Settlement Order that contained findings of fact when it did not conduct an evidentiary hearing and the

Trustee offered no witnesses, evidence, or affidavits to support the findings set forth in the Settlement Order.

5. Whether the bankruptcy court abused its discretion in entering an injunction and making factual findings to support the injunction without any factual record whatsoever.

6. Whether an injunction entered without factual support is void as a matter of law.

7. Whether the bankruptcy court erred in denying Appellants' request for discovery under the circumstances of this case.

8. Whether the bankruptcy court erred in approving the Settlement Agreement where the amount of the settlement exceeds the amount that the Trustee could have recovered from the Picower Defendants in litigation of the Trustee's claims against the Picower Defendants (thus indicating that the Picower Defendants "bought" the permanent injunction to which they were not legally entitled).

STANDARD OF APPELLATE REVIEW

Issues presented on appeal relating to the issuance of the permanent injunction that raise questions of law are subject to *de novo* review. See *In re Halstead Energy Corp.*, 367 F.3d 110 (2d Cir. 2004). "The bankruptcy court's articulation of Rule 9019's standard for evaluating a settlement is a legal issue subject to *de novo* review." *In re Iridium Operating LLC*, 478 F.3d 452, 461 n. 13 (2d Cir. 2007). The abuse of discretion standard applies to "the reasonableness of the bankruptcy court's application of the Rule in approving the Settlement." *Id.*

STATEMENT OF THE CASE

This appeal is related to the First Appeal of the bankruptcy court's order granting the First Injunction that is currently pending in this Court (consolidated Case Nos. 10 CV 4652 (JGK) and 10 CV 7101 (JGK)). Marshall's papers in the First Appeal contain a detailed recitation of the facts giving rise to the BLMIS bankruptcy, the appointment of the SIPA Trustee,

the Marshall class action (“Marshall Class Action”) against the Picower Defendants, and the bankruptcy court’s first order enjoining Marshall from prosecuting the class action and declaring that her claims belonged to the Trustee and the Estate. We will summarize those facts for the convenience of the Court with citations to the more complete discussion contained in the papers filed in the First Appeal. We also provide a more detailed rendition of the facts relating to Appellants’ damages and the Settlement Order.

The Madoff scheme and the SIPA Trustee.

Over a period of approximately 30 years, investors entrusted their life savings to Madoff. According to the Trustee, the total amount invested was approximately \$20 billion. In December 2008, Madoff confessed to perpetrating a massive fraud. The Securities Investor Protection Corporation (“SIPC”) appointed Irving H. Picard as Trustee to liquidate BLMIS under the Securities Investor Protection Act (“SIPA”). Madoff’s personal bankruptcy was subsequently consolidated into the SIPA liquidation of BLMIS. (Marshall Br., First App. at 1.)¹

The Trustee’s complaint against the Picower Defendants.

On May 13, 2009, the Trustee filed a complaint against the Picower Defendants. Picower had invested with BLMIS from 1970 on. He invested a total of \$650 million and withdrew a total of \$7.8 billion which was approximately 35% of the total net cash invested by BLMIS investors, making him the largest beneficiary by far of the Madoff scheme. The complaint alleged that, at Picower’s request, Madoff falsified securities transactions at Picower’s direction in order to create phony back-dated securities losses and that Picower earned 700% - 900% on his investment accounts. The only claims the Trustee brought against the Picower Defendants

¹ “Marshall Br., First App.” or “Marshall Reply Br. First App.” refers to Marshall’s briefs in the First Appeal.

were under the Bankruptcy Code for recovery of preferential and fraudulent transfers and an accounting. (Marshall Br., First App. at 1-2.)

The bankruptcy court’s “net equity” ruling deprived thousands of Madoff victims of any recovery from the Estate.

On March 1, 2010, the bankruptcy court entered an order adopting the Trustee’s “net investment” or “cash in/cash out” methodology for calculating each customer’s claim. The bankruptcy court held that the claims of BLMIS customers whose withdrawals exceeded their deposits “will be denied *and they will not be entitled to participate in a distribution from the estate.*” (Marshall Br., First App. at 2.)

As of May 6, 2011, the Trustee had “determined” a total of 16,513 claims (99.97% of all claims). He has allowed only 2,414 (14.61%) and has allowed those 2,414 claims only to the extent of each customer’s net investment. Moreover, he has not recognized any claims of investors who invested through accounts that were not in their names, such as investment club members and feeder fund investors. Thus, the vast portion of Madoff’s victims will not be compensated by the Trustee and they have not received any SIPC insurance.

The Marshall Class Action seeks to represent thousands of Madoff victims who suffered substantial damages, but who will receive nothing from the Estate.

Marshall filed her complaint in the Southern District of Florida on February 17, 2010, asserting state law tort claims against the Picower Defendants. The Marshall Class Action does not assert fraudulent conveyance or preference claims, or any claims against the Estate or the Trustee. Instead, the claims are for damages suffered by the Marshall class members, which were caused by the Picower Defendants’ participation in the Madoff fraud. The class of victims that Marshall represents is:

BLMIS account holders who had their SIPA claims disallowed in whole or in part or who have not filed SIPA claims with the Trustee, all of whom have independent claims against the Picower

Defendants for, *inter alia*, conspiracy, unjust enrichment, conversion, and violations of the Florida RICO statute that are separate and distinct from those asserted by the Trustee, and that have not been, and cannot be, asserted by the Trustee.

(Marshall Br., First App. at 4; Marshall Am. Compl. at ¶4.)

There are thousands of members of the class, some of whom, like Marshall, have received a SIPC insurance payment for a small portion of their losses but, according to the Trustee, are not entitled to any payment from the fund of customer property because their “net equity” claim, as defined by the Trustee, has been fully satisfied by SIPC. Like Marshall, these investors have assigned their claims to SIPC *only up to* the amount of the SIPC payment. They retained their claims for losses above the amount of the SIPC payment. (Marshall Br., First App. at 4.)

The First Injunction and the First Appeal raise the issue of whether Marshall’s claims “belong to” the Trustee.

On March 30, 2010, the Trustee filed a complaint to enjoin the Marshall Class Action. The Trustee admitted that his ultimate goal was to permanently extinguish Marshall’s claims in order to settle with the Picower Defendants. (Marshall Br., First App. at 5.) On May 3, 2010, the bankruptcy court entered the First Injunction and held that Marshall’s claims “belong to” the Trustee and therefore violated the automatic bankruptcy stay and are *void ab initio*. Marshall argued that the bankruptcy court lacked subject matter jurisdiction to enjoin the Marshall Class Action because Marshall’s claims do not “belong to” the Estate and did not seek Estate assets for the following reasons:

(1) The Trustee stands in the shoes of the debtor criminal and only “owns” claims that the debtor could have brought prior to the SIPA proceeding. Under the Second Circuit’s “*Wagoner* Rule,” Madoff could never have sued the Picower Defendants for aiding and abetting Madoff’s fraud because they are all *in pari delicto*. *Shearson Lehman Hutton, Inc. v. Wagoner*,

944 F.2d 114 (2d Cir. 1991). Because the Trustee lacks standing to assert Marshall's claims, he does not own those claims, and the bankruptcy court lacked jurisdiction to enter the First Injunction. (Marshall Br., First App. at 9-12.)

(2) Marshall has alleged that the Picower Defendants engaged in independent tortious conduct, which caused damages to the Marshall class members that are personal to them. These damages include unrecoverable income tax payments on fictional investment income and the loss of a reasonable market return. Madoff has *not* and could not have suffered these injuries. Thus, the Trustee does not "own" Marshall's claims, Marshall's claims are not property of the Estate, and the bankruptcy court lacks jurisdiction to enjoin the Marshall Action. *See In re Johns-Manville Corp.*, 517 F.3d 52 (2d Cir. 2008). (Marshall Br., First App. at 13-17.)

In addition to holding that Marshall's claims "belong to" the Trustee, the bankruptcy court held that the First Injunction was proper under section 105(a) of the Bankruptcy Code. Marshall argued that there is no legal basis to issue an injunction under section 105(a) so that the Trustee can get "first crack," much less the only crack, at the Picower Defendants' assets, even if the purpose of the First Injunction was to facilitate a settlement between the Trustee and the Picower Defendants. *Johns-Manville, supra*. (Marshall Br., First App. at 18 (citing Fox Br., First App. 23-28; Reply Br. at 17-19²)).

Marshall argued that the Trustee's true objective in obtaining the First Injunction was an attempt to appropriate the Marshall claims against the Picower Defendants that do not belong to him, so that he could promise to later extinguish these claims to achieve a final settlement with the Picower Defendants. In other words, Marshall believed that the Trustee was attempting to obtain a non-consensual third party release from Marshall and the class members in favor of the

² Fox Br., First App." or "Fox Reply Br. First App." refers to Co-Appellant, Adele Fox's briefs in the First Appeal.

Picower Defendants in violation of Second Circuit law. Marshall noted that, if that were to happen, the Picower Defendants would be able to “discharge” their liability to the Marshall class members without compensating them at all for the damages Picower caused them. (Marshall Br., First App., at 19-20.)

Marshall was correct. The Trustee has now settled with the Picower Defendants and obtained a permanent injunction that purports to prohibit the Marshall class from ever pursuing its claims against the Picower Defendants.

The Government’s forfeiture action and the Settlement Agreement between the Trustee and the Picower Defendants.

On December 17, 2010, the United States Attorney’s Office for the Southern District of New York (the “Government”) filed a complaint for forfeiture in the amount of \$7,206,157,717 (the “Forfeited Funds”), which represents the net amount that the Picower Defendants allegedly received traceable to the Madoff scheme. On the same day, the Government and the Picower Defendants signed the Forfeiture Settlement Stipulation, whereby the Picower Defendants agreed to turn over to the Government all of the Forfeited Funds irrevocably. (R. 805-818.)³ Marshall was not given notice of the forfeiture action or an opportunity to be heard.

The Government was working in concert with the Trustee. The Picower Defendants entered into the Settlement Agreement for \$5 billion of the \$7.2 billion forfeiture (the “Bankruptcy Settlement Amount”). To fund the Settlement, the Government agreed to transfer \$5 billion of the Forfeited Funds to the Trustee for him to distribute to BLMIS customers with allowable claims under SIPA. (R. 768.) Therefore, the members of the Marshall class will not receive any of the \$5 billion.

With respect to the remaining \$2.2 billion of the Forfeited Funds, the Government

³ “R” cites refer to the record on appeal filed by Adele Fox in the companion appeal.

appointed the Trustee as Special Master to administer distribution of this money as well to the customers with allowed customer claims. Thus, the Trustee has been given control of the entire \$7.2 billion forfeited by the Picower Defendants. (R. 1097-1098.) The Trustee has stated that he will distribute the \$7.2 billion only to the approximately 14% of Madoff victims he has determined have allowable claims under SIPA.⁴

In the Settlement Agreement, the Trustee agreed that he would seek a permanent injunction of all claims against the Picower Defendants arising out of the Madoff fraud, which necessarily included Marshall's claims. However, the Settlement Agreement is not contingent on obtaining the injunction. (Settlement Agreement at 5, ¶7.) The \$7.2 billion was irrevocably forfeited regardless of whether the bankruptcy court approved the Settlement Agreement or entered the Injunction.

The Settlement Order and the permanent injunction in favor of the Picower Defendants.

Also on December 17, 2010, the Trustee filed his motion for approval of the Settlement (the "Settlement Motion" [Doc. #25 in Adv. Pro. No. 09-01197 (BRL)]). The Trustee sought an order that would expressly bar not only claims that "belong to" the Trustee, but also claims that were "duplicative" of the Trustee's claims against the Picower Defendants. (*Id.*) Marshall opposed the Trustee's Settlement Motion (the "Objection" [Doc. #32 in Adv. Pro. No. 09-01197 (BRL)]). Marshall noted that inclusion of the word "duplicative" has no legal definition and

⁴ See 12/17/10 D.O.J. Press Release, <http://www.justice.gov/usao/nys/pressreleases/December10/picowerforfeituresettlementpr.pdf>, at 1, 2:

The distribution of funds to victims will be administered by [the Trustee] in his dual capacity as the newly-appointed Department of Justice Special Master to assist the [Government] in connection with the victim remission proceedings and as the court-appointed trustee overseeing the liquidation of BLMIS under SIPA. . . . The [Trustee] said: **"Every penny of the \$7.2 billion settlement will be distributed to BLMIS customers with valid claims."** (Emphasis added.)

rendered the injunction ambiguous. (*Id.* at 5, 7-8.) Marshall pointed out that the bankruptcy court lacks subject matter jurisdiction to enter the injunction if “duplicative” means that otherwise independent claims against the Picower Defendants are barred merely because they arise out of the same facts as the Trustee’s claims against the Picower Defendants. (*Id.* at 5-13.) The primary goal of the Objection was to obtain an assurance that, in the event that this Court in the First Appeal concludes that Marshall’s claims are independent and personal, the proposed injunction would not enjoin them. While that concern could have been addressed by adding language to the proposed order to clarify that it would not preclude Appellants’ claims if they are determined to be independent, the Trustee disregarded the suggestion. The Trustee stated that “the permanent injunction will apply to . . . Marshall if entered by this Court because this Court already has ruled that [her] claims are not independent of the Trustee’s claims. (Trustee’s Response to Objections to Picower Settlement [Doc. #36 in Adv. Pro. No. 09-1197 (BRL)], at 9.) The Trustee made clear that the injunction would apply not only to claims that belong to the Trustee, *but also* to claims that are “duplicative” of the Trustee’s claims. (*Id.* at 8) (“[T]he Trustee seeks to enjoin only those claims that he himself has asserted or could have asserted, *or which are duplicative* or derivative of those claims he asserted or could have asserted.”) (emphasis added). In fact, on the night before the hearing to approve the settlement, the Trustee submitted a Notice of Revised Proposed Order with new language enjoining Marshall by name. (Form Revised Order [Doc. #42 in Adv. Pro. No. 09-01197 (BRL)], at 8.)

On January 13, 2011, the bankruptcy court entered the Settlement Order containing the following permanent injunction:

Anyone whose claim in **any way arises from or is related to BLMIS or the Madoff Ponzi scheme**, is hereby permanently enjoined from asserting any claim against the Picower BLMIS accounts or the Picower Releasees *that is duplicative* or derivative of the claims brought by the Trustee, or which could have been

brought by the Trustee against the Picower BLMIS Accounts or the Picower Releasees. . . .

(Settlement Order at 7) (emphasis added.)

The bankruptcy court agreed with the Trustee that Marshall's claims are barred by the permanent injunction. At the hearing on the Settlement Motion, the bankruptcy court stated that he did not need to enjoin Marshall by name because:

I agree with your [the Trustee's] reading of the language in the central decretal paragraph **that duplicative** and derivative **claims** being brought by the trustee are those that are barred. I don't know why you need the second decretal paragraph the speaks specifically to Fox and Marshall. **They are subsumed in the prior injunctive paragraph.**

(1/13/11 Hrg. Trans. at 36:15-20; *see also id.* at 37:2-10) (emphasis added.)

SUMMARY OF ARGUMENT

(1) The bankruptcy court lacked jurisdiction to enjoin the Appellants' claims against the Picower Defendants. These claims are independent tort claims that the Trustee lacks standing to bring under the Second Circuit's *Wagoner* Rule and the independent injury rule. *See Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991); *In re Johns-Manville Corp.*, 517 F.3d 52 (2d Cir. 2008). Similarly, the Trustee does not have standing to assert claims in the Marshall Class Action as an assignee, as a subrogee of SIPC's rights, or as a bailee of customer property.

Appellants' claims are not "duplicative" of the Trustee's in any way that would confer jurisdiction on the bankruptcy court to enjoin them. This is the case even though Appellants' claims arise out of the Madoff fraud and are based on substantially the same facts alleged by the Trustee in his action against the Picower Defendants. Thus, the permanent injunction entered in connection with the Settlement Order should be reversed for the same reasons that this Court

should reverse the First Injunction, which is the subject of the First Appeal.

Controlling Second Circuit law does not permit injunctions that release third party non-debtors like the Picower Defendants, unless there are exceptional circumstances that are not present here. Most importantly, the permanent injunction was not a condition of the Settlement and in no way benefits the customers whose claims the Trustee has recognized. On the contrary, the Picower Defendants irrevocably forfeited the full \$7.2 billion to the Government, even if the Settlement was never approved by the bankruptcy court.

Now that the Trustee has fully released the Picower Defendants, prosecution of the Marshall Action against the Picower Defendants cannot conceivably interfere with the Trustee's administration of the estate. The fact that the Picower Defendants have agreed to a large settlement is irrelevant and does not confer jurisdiction on the bankruptcy court. *Johns-Manville, supra*.

(2) The Injunction was not supported by evidence supporting the need for the injunction, and it is, therefore invalid.

(3) The bankruptcy court was required to consider whether the Settlement was fair to all Madoff victims, not just the select victims who will benefit from the Settlement. The court failed to make any findings regarding whether the Settlement was fair to the thousands of members of the Marshall class, who have been excluded from the Estate and who will receive none of the proceeds from the Settlement. The bankruptcy court ignored the fact that the Settlement is unfair to the Marshall class because it strips the Picower Defendants of assets that should be available to satisfy Marshall's independent claims against the Picower Defendants. The Settlement has the effect of granting the Trustee an impermissible preference over the Picower Defendants assets and denying the Marshall class access to the courts.

(4) The bankruptcy court erred in denying Appellants' Discovery Request.

ARGUMENT

I. THE COURT ERRED IN ENTERING THE PERMANENT INJUNCTION BECAUSE THE BANKRUPTCY COURT LACKS JURISDICTION TO ORDER A NON-CONSENSUAL RELEASE OF INDEPENDENT CLAIMS AGAINST THE NON-DEBTOR PICOWER DEFENDANTS UNDER ESTABLISHED SECOND CIRCUIT LAW.

A. The Bankruptcy Court Lacks Jurisdiction To Bar Marshall's Independent Claims Because They Do Not "Belong To" The Trustee, Even If Marshall's Claims Arise Out Of The Same Facts As The Trustee's.

1. The bankruptcy court once again erred in holding that Marshall's claims against the Picower Defendants "belong to" the Trustee.

There is no question that the bankruptcy court's permanent injunction is intended to bar Marshall's claims against the Picower Defendants. The bankruptcy court reasoned that Marshall's claims can be barred because they "belong to" the Trustee. (*See* Settlement Order at 6.) The bankruptcy court relied on its prior order enjoining Marshall's claims and holding that the Marshall Class Action is *void ab initio*. Therefore, the permanent injunction in the Settlement Order is erroneous for the same reasons set forth in Marshall's briefs in the First Appeal.

To summarize, the bankruptcy court lacks subject matter jurisdiction to enjoin Marshall's claims because the Trustee cannot own Marshall's claims; he lacks standing to bring such claims under the Second Circuit's *Wagoner* Rule. (Marshall Br., First App. at 9-12.) The Trustee cannot own Marshall's claims because Marshall and the members of the Marshall class have suffered an injury that is separate and distinct from any injury suffered by the debtor (*i.e.*, Madoff/BLMIS). Therefore, the Trustee lacks standing to bring Marshall's claims and cannot

own them. (Marshall Br., First App. at 13-17.)⁵

Moreover, the Trustee does not have standing to assert the claims of the Marshall class as an assignee of customers' claims. As a condition to receiving SIPC payments, the Trustee has required BLMIS customers to execute certain Assignment and Release forms that purport to assign to the Trustee any and all rights and causes of action that the assignor has with respect to the BLMIS account. While SIPA section 78fff-2(b) authorizes a SIPA trustee to obtain assignments from customers whose claims he satisfies, it does not permit the Trustee to condition payment on customers' assignment of their claims against third parties. *See In re Park S. Sec., LLC.*, 326 B.R. 505, 514 (Bankr. S.D.N.Y. 2005) (collecting cases).

Courts in this Circuit have consistently held "that the assignments authorized by section 78fff-2(b) of SIPA do not extend to all claims of customers against third parties but, rather, only to a customer's net equity claim." *Id.* at 515 (holding that an assignment does not confer upon the Trustee standing to bring an unjust enrichment claim); *see Picard v. HSBC Bank PLC*, 2011 WL 1544494, at *5 (S.D.N.Y. April 25, 2011) (acknowledging that "at least four courts have concluded that SIPA only permits assignments of customers' net equity claims and not claims against third parties) (collecting cases). In fact, the Trustee's attempts to obtain assignments for third party actions have been interpreted as a "disregard[] of SIPA's plain language" and as an "overreach[] [of] his statutory authority" *Giddens v. D.H. Blair & Co.*, 280 B.R. 794, 803 (Bankr. S.D.N.Y. 2002) (holding that Trustee lacked standing to assert claims for unjust enrichment, aiding and abetting breach of fiduciary duty, and antitrust claims on behalf of assignors).

⁵ Marshall incorporates herein the arguments made in the First Appeal.

Similarly, the Trustee's status as bailee of customer property and subrogee of SIPC's rights does not confer standing. In arguing that he has standing to commence third party actions as a bailee and/or subrogee, the Trustee has predominantly relied upon *Redington v. Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978), *rev'd on other grounds*, 442 U.S. 560 (1979). However, the Trustee's reliance on *Redington* is misplaced. First, as recognized by this Court in *Picard v. HSBC Bank PLC.*, numerous courts in this Circuit "have expressed skepticism about whether . . . [the relevant portion] of *Redington* is still good law." 2011 WL 1544494 at *3 (citing cases). Moreover, the Trustee's standing to pursue customer claims against third parties is inconsistent with SIPA. See *Securities Investor Protection Corp. v. BDO Seidman, LLP*, 49 F. Supp.2d 644, 654 (S.D.N.Y. 1999) (citing *Redington*, 592 F.2d at 634) (Mulligan, J., dissenting) ("Had Congress intended to enable SIPC or the trustee to bring suit against a third party, it would have done so.").

In a recent decision, Judge Rakoff questioned the Trustee's standing to bring various state law claims against third parties on behalf of BLMIS customers. See *gen., Picard v. HSBC Bank PLC*, 2011 WL 1544494. As to the Trustee's first theory of standing as a successor of a joint tortfeasor, Judge Rakoff recognized that the Trustee's standing "may well be precluded by the so-called "Wagoner" doctrine" *Id.* at *7. He further doubted the Trustee's ability to rely on *Redington v. Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978), in support his alleged standing to assert common law claims as a subrogee of SIPC's rights and as a bailee of customer property. *Id.* at *7-11. He noted that "there are reasons to believe that the precedential force of *Redington* has been weakened, *perhaps fatally*" *Id.* at *8 (emphasis added). As to the Trustee's assignee status as the basis for standing, Judge Rakoff noted that "at least four courts have

concluded that SIPA only permits assignments of customers' net equity claims and not claims against third parties. *Id.* at *11.

Since the Trustee lacks standing to assert or release the Marshall Class Action claims because they do not belong to him, the court lacked authority to enter the permanent injunction.

2. The bankruptcy court erred in enjoining Appellants' claims that do not "belong to" the Trustee and are not property of the Estate.

The Trustee and the bankruptcy court have now taken the First Injunction a step further. The injunction in the Settlement Order purportedly bars not only claims that belong to the Trustee, *but also* claims against the Picower Defendants that arise out of the Madoff/Picower fraud and that are "duplicative" of the Trustee's claims against the Picower Defendants. "Duplicative" has no legal definition and is not defined in the Settlement Order. The bankruptcy court clearly stated that the injunction applies to Appellants' claims.

Marshall's claims are not "duplicative" of the Trustee's claims in any meaningful way that would confer jurisdiction on the bankruptcy court to enjoin them. *In re Johns-Manville*, 517 F.3d 52, 65 (2d Cir. 2008), holds that a bankruptcy court lacks jurisdiction to permanently enjoin independent claims against third party non-debtors, even if those claims and claims brought by a trustee arise out of the same transaction and occurrence and are based on the same factual allegations.⁶ *Johns-Manville* arose out of large asbestos-related injury claims resulting in the Chapter 11 reorganization of Johns-Manville Corporation ("Manville"). Manville sued its non-debtor insurer, Travelers Indemnity, for policy proceeds. As part of a settlement between

⁶ *Johns-Manville* was reversed and remanded on other grounds in *Travelers Indem. Co. v. Bailey*, 129 S. Ct. 2195 (2009). The reversal was based on the appellants' failure to timely appeal the bankruptcy court's original order. *Johns-Manville* is controlling law on the bankruptcy court's lack of subject matter jurisdiction to permanently enjoin claims that do not belong to the Trustee. See *In re Dreier LLP*, 2010 WL 1707737, at *15 (Bankr. S.D.N.Y. Apr. 28, 2010).

Manville and Travelers, the bankruptcy court permanently enjoined all direct suits against Travelers by all claimants to the resulting settlement trust. *See* 517 F.3d at 56-57.

After the injunction was issued, a group of claimants/plaintiffs sued Travelers on various common law theories of liability, including Travelers' failure to warn the public of the health issues created by Manville's asbestos products (the "Direct Actions"). The bankruptcy court (Lifland, J.) held that the Direct Actions were barred by the permanent injunction because they arose out of the same circumstances that led to the bankruptcy. *Id.* at 59. The district court affirmed the bankruptcy court's ruling. *Id.* at 59-60. The Second Circuit reversed, holding that the bankruptcy court lacked jurisdiction to enjoin the Direct Actions against a non-debtor because the Direct Actions did not belong to the debtor. This was the case even though the Direct Actions arose out of the same facts as the debtor's claims against Travelers. *Id.* at 67. "Shared facts between the third-party action and a debtor-creditor conflict do not in and of themselves suffice to make the third-party action "related to" the bankruptcy. . . ." *Id.* at 65 (quoting *In re Zale Corp.*, 62 F.3d 746 (5th Cir.1995)).

Johns-Manville is directly on point. The permanent injunction bars claims against the Picower Defendants merely because they arise out of the Madoff fraud and merely because they rely on the same underlying facts as the Trustee's fraudulent transfer claims. Therefore, the injunction is improper and beyond the bankruptcy court's jurisdiction.

Moreover, the bankruptcy court could not create jurisdiction to enjoin Appellants simply because the Picower Defendants made a substantial contribution to the Estate. As the Second Circuit stated in *Johns-Manville*:

It was inappropriate for the bankruptcy court to enjoin claims brought against a third party nondebtor solely on the basis of that third party's financial contribution to a debtor's estate. If that were possible a debtor could create subject matter jurisdiction over any nondebtor third party by structuring a plan in

a way that it depended upon third party contributions.

Id. at 66.

This point was made, as well, in *In re Mrs. Weinberg's Kosher Foods, Inc.*, 278 B.R. 358, 265-66 (Bankr. S.D.N.Y. 2002). The trustee in a Chapter 7 liquidation sought approval of a settlement with a non-debtor third party. The settlement included a permanent injunction in favor of the non-debtor and against any claims “arising from the facts and transactions underlying the [trustee’s] claims.” *Id.* at 361. Although no one objected to the order, the bankruptcy court refused to enter it. The court held that the injunction was too broad because it purported to bar a creditor’s independent claim against the non-debtor, which “does not implicate an injury to the estate.” *Id.* at 365. This was the case even if the creditor’s claims “arise from the facts and transactions underlying the [trustee’s] claims.” *Id.* at 366.

In *In re Devon Capital Mgmt.*, 261 B.R. 619 (Bankr. W.D. Pa. 2001), the bankruptcy court refused to approve an injunctive order in a settlement that purported to bar all claims against the settling non-debtor like the Picower Defendants. The bankruptcy court determined that the injunctive order was prejudicial to creditors with independent claims against the settling non-debtor and violated the principal requiring that “no one has been set apart for unfair treatment” by the settlement. *Id.* at 623.

The Second Circuit has long recognized the dangers of entering injunctions such as the one entered by the bankruptcy court:

A nondebtor release is a device that lends itself to abuse. By it, a nondebtor can shield itself from liability to third parties. In form, it is a release; in effect, it may operate as a bankruptcy discharge arranged without filing and without the safeguards of the Code.

Id. (citations omitted).

Courts almost never approve a third-party release outside of Chapter 11 reorganizations

and, even then, they are granted only in rare and “extraordinary” cases in which the bar order is critical to the reorganization. *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 141-42 (2d Cir. 2005). The BLMIS case is a liquidation, not a reorganization. Moreover, the injunction in favor of the Picower Defendants is clearly not “critical” to the Picower Settlement because it was not a condition of the Settlement.

Finally, releases and injunctions like the one at issue here have been approved only where the enjoined claims were not extinguished, but “channeled” into a fund created under the settlement, and where the enjoined parties could receive “full payment” of their claims from the settlement. *In re Metromedia*, 416 F.3d at 141-42. In such cases, all of the affected parties consented to the bar order. Here, on the contrary, the bankruptcy court extinguished Appellants’ claims, giving the Picower Defendants the same relief they would have received if they had filed in bankruptcy themselves and made a complete disclosure and relinquishment of all of their assets.

Neither the Trustee nor the bankruptcy court cited to a single case enjoining independent claims merely because they are alleged to be “duplicative” of a bankruptcy trustee’s claims. Unless the order below is reversed, the Picower Defendants will have been able to “discharge” all of their tort liability to those with independent claims like Marshall. The Second Circuit has held that this result is improper and beyond the competence of a bankruptcy court. *See Johns-Manville*, 517 F.3d at 66-67.⁷

⁷ Section 524 of the Bankruptcy Code further supports Marshall’s position. Section 524(e) “prohibits the discharge of debts of nondebtors;” therefore, the Bankruptcy Court may not issue an injunction that actually or effectively discharges the Picower Defendants’ liability to Marshall. *In re Zale Corp.*, 62 F.3d 746, 761 (5th Cir. 1995); *see, e.g., In re Combustion Engineering, Inc.*, 391 F.3d 190, 228 (3d Cir. 2004); *In re Lowenschuss*, 67 F.3d 1394, 1401-02 (9th Cir. 1995); *In re Western Real Estate Fund, Inc.*, 922 F.2d 592, 600-02 (10th Cir. 1991).

B. The Trustee Has Conceded, And The Bankruptcy Court Has Held, That A Section 105 Permanent Injunction For The Benefit Of Non-Debtors Like The Picower Defendants Is “Inappropriate.”

The bankruptcy court relied on section 105 of the Bankruptcy Code, which permits an injunction of creditor claims that threaten the integrity or administration of the bankruptcy estate. See *In re American Hardwoods, Inc.*, 885 F.2d 621, 625 (9th Cir. 1989). The Trustee’s main argument below was that the injunction is proper because “. . . Marshall’s action[, if allowed to continue, would interfere with the ongoing administration of the active BLMIS estate.” (Trustee’s Response to Objections to Picower Settlement at 9). However, a section 105(a) stay in favor of a non-debtor like the Picower Defendants is improper as a matter of law because Marshall’s claim do not seek assets of the Estate. (See e.g., *In re Enivid, Inc.*, 364 B.R. 139 (Bankr. D. Mass. 2007) (“The Plan Trustees have not advanced a legitimate reason why their claims against the directors and officers of [the debtor] should be elevated to a higher priority than the claims of the [plaintiffs’], which would be the effect of injunctive relief.”); *In re First Central Fin. Corp.*, 238 B.R. 9, 21 (E.D.N.Y. 1999), *aff’d in unrep. opinion*, no. 99-cv-6730 (E.D.N.Y. Mar. 2, 2000)).

The Trustee’s argument that the Marshall action will “interfere” with the Estate is also clearly incorrect as a matter of fact since the Settlement was not conditioned upon the injunction and since the Trustee has released the Picower Defendants of all claims. Moreover, in another action, the Trustee conceded, and the bankruptcy court held, that once a settlement is reached, claims against third party non-debtors like the Picower Defendants “will [not] have any effect on the BLMIS SIPA liquidation.” *Picard v. Cohmad Securities Corp. et al.*, 443 B.R. 291 (Bankr. S.D.N.Y. Feb. 3, 2011) (Lifland, J.). In *Cohmad*, the Trustee sued Robert Jaffe for his involvement in the Madoff scheme on the same causes of action that he asserted against the Picower Defendants—fraudulent transfers, preferences, turnover, and state law fraudulent

conveyances. *Id.* at 293. The Trustee settled with Jaffe and released him of all claims that the Trustee brought or could have brought against Jaffe, just like he did with the Picower Defendants. *Id.* at 293-94. Jaffe then filed a motion to permanently enjoin a number of third party actions brought against him by BLMIS investors, all of which sounded in fraud. Jaffe argued that the third party claims “belonged to” the Trustee, and were therefore released by the Trustee in the settlement.⁸

In denying Jaffe’s motion to permanently enjoin the third party actions against him, the bankruptcy court held that Jaffe lacked standing to make his motion. The court agreed with the Trustee that the third party actions against Jaffe have *no effect* on the SIPA liquidation in light of the settlement. Therefore, the bankruptcy court held that a permanent injunction under section 105 “*would be inappropriate*, as the Trustee has recovered all customer property of the BLMIS estate from [Jaffe], leaving nothing for this Court to administer.” (*See* Order re: Motion for Protective Order [Doc. # 193 in Adv. Pro. No. 09-01305 (BRL)], at 6).; *see also In re American Hardwoods*, 885 F.2d at 625 (holding that a bankruptcy court lacks subject matter jurisdiction to permanently enjoin a creditor from enforcing a state court judgment against a non-debtor following confirmation of the reorganization plan).

Clearly, the bankruptcy court’s decision in Cohmad is inconsistent with his decision in this case. The injunction shielding the Picower Defendants from the victims of Picower’s criminal conspiracy is beyond the bankruptcy court’s jurisdiction.

⁸ *See* Jaffe’s Memorandum of Law in Support of His Motion for an Order Enforcing this Court’s Settlement Order and Enjoining the Continued Prosecution of the Third Party Actions, Adv. Pro. No. 09-01305, Doc. No. 185, at 10-20.

II. THE INJUNCTION VIOLATES THE CONTENT, SCOPE, AND SPECIFICITY REQUIREMENTS OF RULE 65 OF THE FEDERAL RULES OF CIVIL PROCEDURE AND RULE 7065 OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE.

Even if the injunction was intended to only cover claims owned by the Trustee, the Settlement Order must be reversed because the injunction does not satisfy the applicable federal rules. Pursuant to Rule 65(d), every injunction must state the reasons why it was issued, state its terms with specificity, and describe in reasonable detail the acts to be restrained. These requirements were “designed to prevent uncertainty and confusion on the part of those faced with injunctive orders, and to avoid the possible finding of a contempt citation on a decree too vague to be understood.” *Schmidt v. Lessard*, 414 U.S. 473, 476 (1974) (citations omitted; footnote reference omitted); *Lau v. Meddaugh*, 229 F. 3d 121, 123 (2d Cir. 2000) (quoting *Gunn v. Univ. Comm. To End War in Vietnam*, 399 U.S. 383, 388 (1970)) (“Compliance with . . . [Rule 65(d)] is essential because ‘until a district court issues an injunction, or enters an order denying one, it is simply not possible to know with any certainty what the court has decided.’”). As the Supreme Court observed in *Schmidt*, “[s]ince an injunctive order prohibits conduct under threat of judicial punishment, basic fairness requires that those enjoined receive explicit notice of precisely what conduct is outlawed.” 414 U.S. at 476.

The injunction is neither specific in its terms nor does it describe in reasonable detail the conduct sought to be restrained. Consequently, it is unclear exactly what actions are prohibited. While the Trustee urged the bankruptcy court to enter the injunction because it is narrowly tailored and is only intended to prevent third parties from bringing estate claims (*See* Settlement Motion at 23-27), the language of the injunction is far broader. If the Trustee truly intended for the narrower construction to apply, he should have modified the proposed injunction prior to entry to make it clear that any claims asserted by the Appellants that are not property of the

Estate fall outside of the injunction. The improper scope of the injunction could have been easily corrected to clarify that the injunction covers only actions that belong to the Trustee and does not cover actions that are not property of the estate.

III. The permanent injunction should be reversed because it was not supported by any evidence.

A. The Standards For Issuing Permanent Injunctions.

Pursuant to Rule 65(d), an order entering a permanent injunction “shall set forth the reasons for its issuance.” *Knox v. Salinas*, 193 F.3d 123, 129 (2d Cir. 1999). An order should be reversed if it fails to include “special findings of fact and conclusions of law” as to why the permanent injunction is necessary. *Id.* (reversing permanent injunction). The Second Circuit has “not hesitated, on numerous occasions, to invalidate injunctions for lack of adequate findings.” *Alleyne v. New York State Educ. Dept.*, 516 F.3d 96, 101 (2d Cir. 2008) (citations omitted).

In order to be entitled to a permanent injunction, the Trustee was required to prove: (1) an irreparable injury; (2) that legal remedies, such as monetary damages, are inadequate to compensate for the injury; (3) that, considering the balance of hardships, a remedy in equity is warranted; and (4) that the public interest would not be disserved by the injunction. *See eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006). These factors should apply in SIPA liquidation proceedings. *See id.* (applying the factors in a patent case because “a major departure from the long tradition of equity practice should not be lightly implied”). The bankruptcy court was required to assess these factors based upon evidence, not assumptions. *See U.S. Phillips Corp. v. Iwasaki Elec. Co., Ltd.*, 607 F. Supp. 2d 470 (S.D.N.Y. 2009). An evidentiary hearing is required when the facts supporting injunctive relief are disputed. *Maryland Casualty Co. v. Realty Advisory Bd. on Labor Relations*, 107 F.3d 979, 984 (2d Cir.1997).

B. The Injunction Was Erroneous Because It Was Not Supported By Sufficient Findings.

The bankruptcy court failed to take evidence on material issues as to which there were disputed facts and failed to make sufficient findings of fact to support the injunction. The only evidence offered was the Trustee's affidavit, which was attached to the Settlement Motion (*See* Settlement Motion at Exhibit D). The substance of the Trustee's affidavit was that, in his judgment, the settlement was fair to the Picower Defendants. (*Id.* at ¶ 9.) The Trustee also offered his opinion that the settlement will be fair to Madoff victims (*id.* ¶ 6, 8), but he failed to explain how the settlement was fair to Appellants. Nor did he describe the injury to the Estate that would occur if the injunction was not entered. While the Trustee's counsel claimed that the injunction was necessary to protect the administration of the SIPA estate, the Trustee did not offer any proof on that matter. The Trustee also failed to adduce any evidence on the four elements of injunctive relief.

The bankruptcy court failed to make any findings of fact supporting the need to permanently enjoin Appellants, as required under *Knox, supra*. The court made a conclusory finding of law that the injunction was necessary to preclude actions that would have an adverse impact on the estate or the administration of the liquidation proceedings. (*See* Settlement Order at 6-7, ¶¶ 8-9.) But the court ignored the fact that, as a matter of fact, the injunction was completely unnecessary to the Settlement, because the \$7.2 billion was irrevocably forfeited by the Picower Defendants, regardless of whether the Settlement was approved by the court or the injunction was entered by the court. The bankruptcy court's conclusion of law is also in direct conflict with its earlier ruling in the *Cohmad* decision, which held that an action against a non-debtor (like the Picower Defendants) cannot have any effect on the estate once the Trustee settles with and releases the non-debtor.

The Settlement Order is also devoid of any findings of fact or conclusions of law relating to the four elements for granting injunctive relief. Remand is unnecessary because those four elements cannot be proven by the Trustee. First, there is no irreparable harm to the Trustee if no injunction is entered. Second, the injunction is inequitable considering the balance of the hardships. On the one hand, the bankruptcy court purported to extinguish the independent claims of the Appellants against the Picower Defendants; on the other hand, the court precluded the Marshall class from participating in the Settlement. Thus, the court erroneously stripped a large class of Madoff victims of a remedy for injuries that only they have standing to pursue. The court also affected a non-consensual release in favor of the Picower Defendants who never undertook the disclosure burdens required of debtors in bankruptcy. For these same reasons, the injunction fails to serve the public interest. The public is not served by shielding criminals from the claims of their victims.

The bankruptcy court failed to explain its reasons for entering the injunction because, in fact, the injunction is insupportable as a matter of fact and law.

IV. THE SETTLEMENT AGREEMENT IS THE PRODUCT OF JUDICIAL ERROR AND SHOULD BE REVERSED.

A. The Bankruptcy Court Failed To Consider Whether The Settlement Was Fair To Non-Parties Such As Appellants.

The Settlement Agreement is the product of cumulative, material legal mistakes. Since 2010, the bankruptcy court has incorrectly believed that the Trustee “owned” Marshall’s claims, and that Marshall had no claims under substantive law. Similarly, the bankruptcy court incorrectly held that in suing Picower, Marshall was contemptuously seeking to circumvent the court’s “net equity” ruling. It is therefore not surprising, having already made these incorrect and prejudicial rulings, that the bankruptcy court repeated and perpetuated them in approving the settlement and enjoining Marshall’s lawsuit permanently. As a result of these cumulative

mistakes, the Settlement is patently unfair to Appellants.

A bankruptcy court must take evidence on and consider the impact of a settlement on non-parties to the settlement agreement. *In re Aweco, Inc.*, 725 F.2d 293, 299 (5th Cir. 1984). Ignoring the effect on the rights of third-parties “contravenes a basic notion of fairness.” *Id.* at 298. The bankruptcy court failed to make any express findings regarding whether the Settlement is fair to the Marshall class members.

For example, in *In re Aweco*, the bankruptcy court approved a settlement between the trustee and a non-debtor, which resulted in a benefit to only some of the estate creditors. *See* 725 F.2d at 296. A creditor, who was not a party to the settlement, objected. The bankruptcy court took testimony and other evidence primarily on the fairness of the settlement as between the settling parties. *Id.* The bankruptcy court approved the settlement. The non-settling creditor appealed, arguing that “the principals of fairness and equity fell victim to the perceived need for speed in approving the settlement.” *Id.* at 297.

The Fifth Circuit agreed and reversed. The issue on appeal was whether the nonparty to the settlement could object because the settlement kept it from “being paid in full.” The appellate court held that the bankruptcy court abused its discretion because it relied on “unsubstantiated, gratuitous declarations” regarding the facts underlying the fairness of the settlement. *Id.* at 299, 300 (“The bankruptcy judge should not reach for his stamp marked ‘approved’ unless some party supplies concrete facts.”).

In *In re Aweco*, the bankruptcy court was reversed even though it took *some* evidence relating to the fairness to a non-party to the settlement. Here, the bankruptcy court took no evidence regarding fairness to the Appellants and denied Marshall’s request to take discovery on that issue. Therefore, the bankruptcy court committed an abuse of discretion. *See id.* at 299

(“An approval of a compromise, absent a sufficient factual foundation, inherently constitutes an abuse of discretion.”).

B. The Settlement Is Not Fair To The Thousands Of Madoff Victims In The Marshall Class Because It Gives The Trustee An Improper Preference And Priority To The Picower Defendants’ Assets.

Through the injunction, the Trustee has prevented the Appellants from recovering against the Picower Defendants for the damages they suffered as a result of Picower’s criminal conspiracy with Madoff. Thus, the bankruptcy court granted the Trustee an improper priority to the Picower Defendants’ assets and has denied the Marshall class members their right of access to the courts.

The Marshall class and the Trustee enjoy equal legal priority with respect to their claims against the Picower Defendants. *Cf. In re Colonial Realty*, 980 F.2d 125, 131-32 (2d Cir. 1992) (recognizing that fraudulent transfer claims against transferees are not independent claims). Marshall was therefore entitled to litigate her claims against the Picower Defendants in parallel with and at the same time that the Trustee was litigating his avoidance claims against the Picower Defendants. As a result of the bankruptcy court’s series of erroneous orders and injunctions, however, the Marshall class has been unable to prosecute its valid claims. Accordingly, judicial error alone has created an inequitable preference in favor of the Trustee and has deprived the Marshall class of victims of an equal chance to bring suit on their independent claims.

The record shows that the Trustee used the bankruptcy court’s orders to exploit improperly granted priority, shut out the Marshall class members, and then take more in settlement than could be recovered in a *bona fide* litigation. For example, the Trustee originally took the position that he was entitled to recover more than the \$2.4 billion transferred to the Picower Defendants in the six years prior to the date of the bankruptcy. The Trustee argued that

he could avoid the six year statute of limitations on fraudulent transfers because the Picower Defendants engaged in actual fraud.⁹ However, in his settlement approval papers, the Trustee stated that that Picower's conduct may *not* have been fraudulent,¹⁰ and he thereby abandoned the legal theory that would permit him to reach farther back in time and recover more than \$2.4 billion. Yet the Trustee nevertheless has recovered significantly more than his legal entitlement through the forfeiture and bankruptcy settlement by appropriating the *assets* otherwise available to satisfy the claims of Appellants. The bankruptcy court allowed this to happen because it erroneously believed that Marshall had no claim to the Picower Defendants' assets. Approval of the Settlement is, therefore, itself erroneous for failure to give due consideration to Appellants' rights.

We have found no case in which a court has been permitted to decide which of two valid claims it prefers, and then give the favored claimant an unfair advantage in litigation or settlement. But that is precisely what happened here. As a result, the Picower Defendants were permitted to transfer assets beyond the reach of Appellants and, thereby, avoid liability to thousands of victims of Picower's criminal conspiracy. But for the bankruptcy court's improvident endorsement of this result, it would be a fraudulent transfer. As in *In re Aweco*, the settlement is not fair to Appellants, in part, because it deprives them of any recovery on their claims against the Picower Defendants.

V. THE BANKRUPTCY COURT ERRED IN DENYING APPELLANTS' REQUEST FOR DISCOVERY UNDER THE CIRCUMSTANCES OF THIS CASE.

As set forth above, the bankruptcy court failed to adequately substantiate the Trustee's

⁹ Memo of Law in Opp. To Defs. Mot. To Dismiss at 51-57, Adv. Pro. No. 09-1197(BRL), Doc. No. 11.

¹⁰ Settlement Motion at 8.

stated reasons for why he would have been entitled to recover more than \$2.4 billion from the Picower Defendants. The discovery sought below by Marshall was designed to develop an adequate record to either support or refute the Trustee's claims. Therefore, the bankruptcy court should have been granted leave to take such discovery.

CONCLUSION

For the reasons set forth above, Appellants request that the Court reverse and vacate the Settlement Order and the injunction because the bankruptcy court lacked jurisdiction to enjoin Appellants' suits against the Picower Defendants and because the bankruptcy court had no authority to give the Trustee a preference over other creditors of the Picower Defendants and to shield the Picower Defendants from liability to the victims of Picower's criminal conspiracy with Madoff.

May 10, 2011

Respectively submitted,

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individually and on behalf of a similarly
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whose claims are not recognized by the
Trustee