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1 UNITED STATES DISTRICT COURT
1 SOUTHERN DISTRICT OF NEW YORK

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2
3 IRVING H. PICARD,

3
4 Plaintiff,

4
5 v.

11 Civ. 3605 (JSR)

5
6 METS LTD. PARTNERSHIP,

6
7 Defendant.

7
8 -----x

8 New York, N.Y.
9 August 19, 2011
9 4:10 p.m.

10
10 Before:

11 HON. JED S. RAKOFF,

12 District Judge

13 APPEARANCES

14 BAKER HOSTETLER

15 Attorneys for Plaintiff

15 BY: DAVID J. SHEEHAN

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18 Corporation

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20 Attorneys for Defendant

20 BY: KAREN E. WAGNER

21 DANA M. SESHENS

21 ROBERT B. FISKE, JR.

22 ROBERT F. WISE, JR.

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1 (Case called)

2 THE COURT: Good afternoon. Welcome to my ballpark.

3 I'm anxious to hear argument on this interesting
4 motion to dismiss/summary judgment motion, but let me deal with
5 a few preliminaries.

6 First, you can assume that I've read all your papers,
7 the moving brief, the answering brief, the reply brief, the
8 supplemental brief, the sur-supplemental brief, et cetera, so
9 you don't need to feel that you need to repeat all of those
10 things in those briefs.

11 It was fortunate, actually, that you gave me so much
12 paper because otherwise I probably would have had to watch a
13 Mets game, which would have been a very painful process.

14 But the one thing that was not in the briefs was any
15 reference, of course, to the Second Circuit's decision of
16 earlier this week, so I am anxious to hear from both sides how,
17 if at all, you think that decision affects this motion.

18 Secondly, barring very unforeseen circumstances, I am
19 unlikely to decide this motion from the bench. So I think at
20 the end of the argument we should go ahead and on the
21 assumption, which may be completely untrue, but just on the
22 assumption arguendo that the motion won't be denied in its
23 entirety, we should set a discovery trial and a trial date. It
24 seems to me the more I look at this case, the more it should
25 remain in the district court and, therefore, we might as well

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1 go ahead and set that schedule now. So I just wanted to flag
2 that for you in advance.

3 With those preliminaries out of the way, let me hear
4 first from moving counsel.

5 MS. WAGNER: Thank you, your Honor.

6 Your Honor, as you have alluded to, there has been a
7 great deal of briefing in this case and I think what has been
8 achieved --

9 THE COURT: Lots of legal fees.

10 MS. WAGNER: Lots of legal fees.

11 But also I think we have sharpened the focus before
12 your Honor. And I think the focus really is whether the
13 transactions that occurred before the SIPC filing for BLMIS
14 were governed by the law in place at the time or whether
15 somehow the filing of the SIPC proceeding changed the law in
16 effect at that time.

17 Your Honor, if I may, I would like to address briefly
18 what that law was. Then I would like to address some of the
19 responses from the trustee in SIPC and then I would like to
20 discuss how the Second Circuit affects any of this, if that's
21 agreeable to your Honor.

22 THE COURT: Yes.

23 MS. WAGNER: Your Honor, under the prefiling law, the
24 law in effect at the time that these transactions occurred,
25 there was no duty imposed on any brokerage customer to

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1 investigate his broker. The rules that governed the
2 transactions at the time were pretty much the rules under the
3 Uniform Commercial Code. And under the Uniform Commercial
4 Code, as we said at great length in our briefs and I won't
5 repeat it all here, once the broker issues a statement, the
6 customer has a securities entitlement and the broker has an
7 obligation. And we take the position that that obligation
8 constitutes an entity with debt and a payment on it, when you
9 later analyze it under the bankruptcy code, cannot be avoided.

10 THE COURT: So one of the, if you will, policy
11 arguments that your adversary puts forth is -- while he doesn't
12 accept the statement of the law you just gave, assuming for the
13 sake of argument that that's correct, when you get in a
14 situation where a trustee has to, in effect, make decisions as
15 to how to deal with a fraud from the standpoint of innocent
16 victims, some victims may be, if you will, more innocent than
17 others.

18 And so even assuming for the sake of argument that you
19 had no duty to investigate, if nevertheless he says, events
20 should have triggered some inquiry by you, not that you had a
21 duty to do it, but just as a matter of what you knew as
22 compared to what others knew, is it not appropriate, if the law
23 permits this for a bankruptcy trustee to distinguish between
24 your situation and that of someone who is totally innocent who
25 had no such inquiring notice or anything of the kind?

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1 MS. WAGNER: No, your Honor, it's not appropriate.
2 The law that is in effect at the time of these transactions is
3 what governs the substantive rights of the parties. When some
4 kind of insolvency proceeding ensues, then a bankruptcy trustee
5 does have the right to avoid preferences and fraudulent
6 conveyances.

7 But the law in effect at the time is what tells you
8 whether there is or is not something that can be avoided. You
9 don't change the law that was in effect at the time. So if the
10 law in effect at the time says there is an obligation that was
11 valid and the payment was on that obligation, then it can't be
12 avoided and it just doesn't matter what anybody knew, and the
13 trustee can't change that law. If the trustee can prove that
14 there was no valid obligation there, then obviously things are
15 different.

16 THE COURT: Are you saying that regardless of what the
17 person to whom the antecedent debt was owed knew, even the case
18 of he knew that an actual fraud was being perpetrated.

19 MS. WAGNER: I am saying what governs is Section 8-105
20 of the UCC. 8-105 says there is three possibilities for
21 avoiding that obligation. One is that you knew. So if you
22 actually knew, then there will be a question about whether the
23 securities entitlement is valid. Another one is if you had a
24 duty imposed by a statute or a regulation to investigate and
25 that investigation would have demonstrated the fraud and you

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1 didn't do it, that's another basis for --

2 THE COURT: You are saying there was no such duty. I
3 understand.

4 MS. WAGNER: I'm saying there was no such duty.

5 The third one is willful blindness. The willful
6 blindness is something very, very close to knowledge. It's
7 definitely some kind --

8 THE COURT: I just want to be clear. You're only
9 addressing this to the middle of those three prongs.

10 MS. WAGNER: That's correct, your Honor.

11 THE COURT: Go ahead.

12 MS. WAGNER: Your Honor --

13 THE COURT: Then why hasn't for the purposes of either
14 a motion to dismiss or for summary judgment hasn't the
15 plaintiff pled enough to at least make a jury issue on the
16 question of willful blindness?

17 MS. WAGNER: Your Honor, there is two answers to that,
18 I think. Number one, the complaint has a lot of allegations in
19 it and it uses the words willful blindness and other words all
20 through it. But in fact it doesn't plead anything that in my
21 view would amount to willful blindness.

22 What it basically pleads is that over the course of 25
23 years, magazine articles appeared that said, wow, we do not
24 fully understand how Bernie Madoff is trading. Other times
25 people said, gee, maybe he is front running and things like

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1 that happened and for that reason, and this is in the complaint
2 in multiple allegations, the Sterling defendants had some duty
3 to investigate, to do due diligence into their broker's
4 obligations. And they didn't do that, so therefore they should
5 be penalized by a billion dollars.

6 THE COURT: Aren't they saying that you had sufficient
7 suspicions that you took out fraud insurance for or looked to
8 take out fraud insurance and also that on one occasion, the
9 Cablevision situation, where you sought to get some of your
10 money back, Madoff put you off with an excuse that you knew was
11 phony? That's the allegation.

12 MS. WAGNER: I'll address each of those, your Honor.
13 On the fraud insurance, I think if you look at our papers, we
14 have demonstrated pretty conclusively somebody said to us, hey,
15 you should look into this and we said, okay, we will look into
16 it. And we looked into it and said, we don't need fraud
17 insurance and we never bought it and we never explored it. And
18 despite the fact that there is big allegations about a shopping
19 spree, there was never a shopping spree. It was never taken
20 seriously and the allegations that it was linked somehow to
21 Madoff and the Ponzi scheme and all that, that's demonstrated
22 in our papers to be false.

23 THE COURT: Did the trustee ever have discovery on
24 that issue?

25 MS. WAGNER: Yes, he did, your Honor. He had

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1 discovery of us, certainly. He has not disclosed to us all of
2 the discovery he had from other people, but he has had from
3 other people as well. But he has certainly had from us and he
4 certainly explained that this was nothing to do with shopping
5 for Ponzi scheme insurance.

6 The other issue is the transaction pursuant to which
7 there was a deal closing for the Sterling defendants that
8 needed \$54 million. They had asked the bank for it. The bank
9 had agreed to lend it, but the money had to come in and the
10 window was closing to do the deal. So they asked Madoff if
11 they could take 54 million out of their accounts. This was
12 money in their accounts at BLMIS.

13 He said, don't do that because I'm in the market and
14 you'll lose the benefit of being in the market, so I'll just
15 lend it to you. And he sent the money and it was sent right
16 back because the bank provided the money at the same time.
17 That was the end of it. There was some peculiar document
18 written to record an obligation to Mrs. Madoff which was -- the
19 testimony is unclear what he was supposed to do. But the
20 trustee --

21 THE COURT: Let's not gloss over that so quickly.
22 From everything your client knew, either that was a false
23 statement or it made no sense.

24 MS. WAGNER: I agree, your Honor, that it didn't make
25 too much sense, but we are not sure where it came from. It was

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1 not -- the allegation is not that Madoff drafted the document.
2 The allegation is that it came from the Sterling defendants and
3 that it was somehow intended to record a repayment obligation.
4 But there was no need for it after the repayment, after the
5 money is repaid. So while it's somewhat inexplicable, there is
6 no basis for claiming any kind of fraud. Nobody could be
7 defrauded by it. Madoff knew what was going on. The banks
8 knew what was going on.

9 THE COURT: But the suggestion is, as I understand it,
10 that the fact that all these kinds of machinations have been
11 gone through and all you wanted was to just get some of your
12 money back that you should have been able to get back, if he
13 was really investing it the way he said he was, should have
14 been a red flag that made you, taken together with everything
15 else, made you realize something wrong is going on here.

16 MS. WAGNER: Your Honor, I think I think the evidence
17 demonstrates that we had been clients or customers of Madoff
18 for quite a while by then. There was a trust between the
19 parties. He said, don't take a loss on your investments. I'll
20 just loan it to you. He was well secured by the other funds
21 that were at the broker. So I think that our clients didn't
22 think one thing about it. They thought it was a nice thing for
23 him to do. It didn't take too long to repay him. It was done
24 immediately and it was wiped clean.

25 Exactly why the repayment obligation that was recorded

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1 in the document occurred is not completely clear, but it
2 doesn't seem to bear on much of anything. There is no argument
3 here that Madoff himself was engaging in any kind of
4 transaction to defraud us or them or anybody else. Everybody
5 knew what was going on. And there was no -- it all happened
6 very quickly and there was no -- nothing that resulted from it
7 that would have suggested any kind of a fraud.

8 THE COURT: I interrupted you. So go on with what you
9 wanted to say before.

10 MS. WAGNER: I certainly will, your Honor.

11 Now, the willful blindness standard, as we have
12 briefed at great length, requires that in order to invalidate a
13 securities entitlement that the holder of the entitlement know
14 facts about a significant probability in this case, there is a
15 Ponzi scheme going on and a lack of trade and that they turned
16 away from information that was available to them that would
17 have established the fraud. There is just simply no allegation
18 anywhere in the complaint that would get to the willful
19 blindness standard. The only allegations are, gee, you should
20 have put together all these things that happened over the
21 course of 25 years and you, unlike the SEC and all the other
22 customers, should have figured this out. That is just not the
23 willful blindness standard, your Honor, and there is no
24 allegation that would suggest that you would meet that.

25 In addition, your Honor, as you know, this is a

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1 summary judgment motion. We have put in evidence that
2 demonstrates --

3 THE COURT: It's not necessarily a summary judgment.
4 You made the request that it be.

5 MS. WAGNER: We made the request, yes, and we put in
6 evidence that would demonstrate in our view that the
7 allegations are not true. We have put in evidence that shows
8 that the allegations are undercut in every material instance by
9 discovery that was available to the trustee at the time that
10 the allegations were made.

11 And so it is our position that there is no material
12 admissible evidence to support any standard here, certainly not
13 a willful blindness standard, but in fact any standard. It is
14 our view that no matter what standard you choose the trustee's
15 complaint has to be dismissed and, of course, we do say it
16 should be with the willful blindness standard.

17 Your Honor, to the best of my knowledge, the trustee
18 has never taken issue with that being the standard prior to the
19 filing of the SIPC proceeding. The trustee rather suggests, I
20 believe in SIPC, that after the SIPC proceeding starts
21 something happens that causes the standard to change. It
22 becomes a good-faith standard or inquiry notice, or something
23 like that.

24 They point to SIPA, to the bankruptcy code. SIPA has
25 no avoidance provisions in it. The avoidance provisions that

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1 you use when you're in a SIPA proceeding are those of Title 11.
2 There is nothing in SIPA that would tell you that somehow use
3 of avoidance provisions changes what went on before.

4 So you are then focused on Title 11. Title 11 has
5 nothing in it either that would suggest that the law changes
6 whenever an insolvency proceeding is commenced and, in fact, as
7 we have briefed, there are many Supreme Court cases that say
8 the law doesn't change. The rights and duties of the parties
9 are governed by nonbankruptcy law. It is absolutely the case
10 that when you make a claim in a bankruptcy proceeding the
11 priority and distribution to that claim will be governed by the
12 insolvency law. But the underlying claim itself and the rights
13 of the parties are not changed as a result of the filing of the
14 insolvency proceeding. I don't think there is any debate that
15 it doesn't change. Neither SIPA nor the bankruptcy code
16 changes it.

17 Then the question might be, does anything the Second
18 Circuit said change any of this. And the answer to that is no.
19 There were basically two sets of issues decided by the Second
20 Circuit. As relevant here, the first set involved a repeated
21 finding that BLMIS claimants are customers with claims for
22 securities and the Second Circuit based that holding in part on
23 the fact that they had written confirmations that Madoff had
24 traded for them.

25 So we would suggest to your Honor that that holding of

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1 the Second Circuit is directly supportive of our position here
2 that when you have securities brokerage statements and you're a
3 customer of a broker/dealer, then you have a claim based on
4 what you understand your broker to owe you. The same holding,
5 I would suggest, and we will talk about it a little later, also
6 demonstrates that Section 546(e) of the bankruptcy code also
7 applies here.

8 The other part of the decision is not relevant here.
9 In the other part of the decision the Court ruled that after a
10 SIPA filing, SIPA gives SIPC and the trustee the discretion to
11 determine how to calculate the priority portion of a customer's
12 claim. And under SIPA, when a broker fails, customers have
13 priority and they have priority to the extent of what is called
14 their net equity claim. To the extent they don't have a net
15 equity claim, then they have a creditor claim.

16 So the Court decided that under provisions of SIPA,
17 the net equity definition and another provision that governs
18 payment to customers, the trustee was entitled to exercise
19 discretion to figure out how to determine the amount of that
20 net equity claim. And the reasoning that the Court used is
21 that the definition of net equity included the concept of
22 securities positions. When you combine that with the other
23 provision they were looking at, which refers to books and
24 records, it was obvious that there were no securities traded,
25 so there were no securities positions.

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1 So, therefore, the Court concluded the trustee and
2 SIPC were within their rights to say we are going to protect
3 the SIPC fund from claims based on securities that weren't
4 there, and we are going to do what we perceive to be equity as
5 far as allocation of the fund of customer property, which is
6 where the net equity claims get paid from. And so we agree
7 that the trustee has discretion to use the net investment
8 method.

9 THE COURT: Which would implicate not the issues
10 raised in your motion, you are saying, but would implicate what
11 ultimately your claims might be. It would be much more
12 supportive of your claim for principal than your claim for
13 profits.

14 MS. WAGNER: I don't think that's correct, your Honor.

15 THE COURT: Why not?

16 MS. WAGNER: I think what the Court was saying was two
17 different things are going on here. One is, what is the claim.
18 One is, how do we figure out what your recovery is going to be.

19 I think what the Court was saying, as far as the SIPC
20 fund and the fund of customer property, we are going to give a
21 priority to certain parts of the customer claim. We are not
22 saying not whole claim isn't valid. We are just saying,
23 because there were no securities here, we are going to allow
24 the trustee to do what he wants to do as far as defining what
25 the priority portion of the claim is. That has nothing to do

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1 with the idea of principal or profit. It has nothing to do
2 with anything except these provisions of SIPA which allow
3 you -- which the Court concluded allowed them to exercise their
4 discretion to do this. Once they paid the net equity portion
5 of the claim there is still the rest of the claim remaining.

6 For our purposes, the only issue is, is there an
7 antecedent debt, and it doesn't matter that part of it has a
8 priority for payment purposes and part of it doesn't.

9 THE COURT: I understand that point.

10 MS. WAGNER: Your Honor, I think that, in fact, the
11 Second Circuit's ruling, as far as that is concerned, is not
12 relevant, and our case, obviously, is one in which the estate
13 is going after customers. It is not a situation in which
14 customers are trying to recover from the estate. So I think it
15 is quite different, and I think the Second Circuit also
16 suggests in some of its opinion that it thinks that avoidance
17 provisions might be helpful to making sure that people don't
18 cause a broker, just before he files, to establish obligations
19 that are fraudulent and then will be paid by SIPC.

20 So they are trying to protect the SIPC fund and the
21 customer fund, but I think they were very careful to make sure
22 to tell everybody they were not addressing at all what is the
23 issue as far as a claim by the trustee against parties, as far
24 as all the transactions they did for 25 years before the SIPC
25 fund.

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1 Your Honor, we argued at some length what the trustee
2 is really doing here is a preference claim. The trustee has
3 said that the biggest asset of his estate is the money Madoff
4 stole from some to give to others. Well, that is a preference
5 concept. All the claimants are customers. That's what the
6 Second Circuit has held. Taking from one creditor giving to
7 another creditor is a preference. And SIPC says, similarly,
8 that allowing one customer to keep something at the expense of
9 another is unjust, so we have got to get it back. Those are
10 preference concepts, your Honor.

11 As we discussed at some length, the bankruptcy code
12 has a 90-day limit on preference and here there is no limit
13 whatsoever that the trustee is imposing on himself as far as
14 reaching back to undue transactions. In this case, of course,
15 we argue that Section 546(e) of the bankruptcy code does not
16 permit any preference anyway. Under Section 546(e) --

17 THE COURT: What do you think to be the purpose of
18 that section? It's a strange section in some ways and perhaps
19 your argument might be, we don't worry about purpose, we just
20 take the plain language and that's that. But what do you think
21 is the purpose?

22 MS. WAGNER: Your Honor, my understanding of the
23 purpose, why it was originally enacted is because there was
24 increasing activity in the markets, derivatives, the denatured
25 securities, speed in the markets, all of those issues were

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1 becoming more and more prized in the financial services world.

2 And so the Congress decided to balance the need to
3 avoid certain transactions after a broker failed with the need
4 to have speed in transaction and to make sure that they were a
5 certainty in the commercial world. So the balance was that
6 transactions could not be avoided when they were done in the
7 financial services world for more than two years and no
8 preferences.

9 The law was first phrased as settlement payments and
10 then after a lot of court decisions we don't know what that
11 means -- it was a poor definition -- Congress changed it and
12 made it even more broad. Now it says any payment in connection
13 with a securities contract. Your Honor, it appears on its
14 face, it would apply here.

15 Also, I would suggest to you that the purpose of it is
16 well served by applying it here because if you allow a trustee
17 to go back and undo 25 years of transactions with a broker,
18 that is certainly not going to engender any kind of confidence
19 in an investor who wants to invest with his broker. I think
20 both purposes are served here.

21 I would also suggest that the Second Circuit now,
22 having held that the BLMIS claimants are customers with claims
23 for securities, 546(e) absolutely applies because if that claim
24 is for securities, they have to have arisen from securities
25 contracts, and I don't understand that the trustee really

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1 disagrees that BLMIS took money from customers with the
2 obligation of buying securities for them. BLMIS breached that
3 obligation, but there was a contract and these transactions
4 were in connection with securities.

5 Your Honor, I would suggest to you that it's very
6 clear 546(e) applies and bars any avoidance more than two
7 years.

8 THE COURT: There again, unless there was actual fraud
9 or the equivalent of willful blindness.

10 MS. WAGNER: If there is the equivalent of willful
11 blindness then you're limited to a two year period, that's
12 correct, your Honor.

13 Your Honor, I was going to address Stern v. Marshall
14 with you, but it appears that's not necessary because it sounds
15 like your Honor has decided to keep this case.

16 THE COURT: Let me hear from trustee counsel.

17 MR. SHEEHAN: Thank you, your Honor.

18 I do intend to respond to my adversary. I would like
19 just set the table, if I may.

20 THE COURT: Yes.

21 MR. SHEEHAN: There are certain statements made here
22 that aren't what we really pled and they are not really in the
23 case. We are not going back 20, 25 years in terms of knowledge
24 or bad faith or inquiry notice or willful blindness. That's
25 just not true. It is very clear in the complaint, even though

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1 it's restated here, it's not accurate. We have got two prongs
2 to this complaint and they are both supported by the Second
3 Circuit decision. I'll explain why.

4 The first is the \$300 million of other people's money.
5 This is a Ponzi scheme. You can wrap it up and call it a
6 securities fraud, you can wrap it up and call it broker/dealer,
7 you can say all those things, but it is a Ponzi scheme and per
8 force the defendants have other people's money, \$300 million of
9 it. There is only one way that's going to come back and that's
10 through the fraudulent conveyance statutes that are empowering
11 the SIPA trustee to bring it back. And the Second Circuit
12 supports that.

13 The Second Circuit says what? What we are talking
14 about here is fictitious profits. You can't rely upon the
15 statement that's built upon a fictitious market and say, I can
16 keep fictitious profits. They have rejected that out of hand.
17 Why? Why would they do that? Because to do otherwise is to do
18 what, is to embrace, embrace the fraud of Mr. Madoff. To
19 enforce it, to suggest that those who got somebody else's money
20 can now keep it. Those who don't have that money don't get it.

21 THE COURT: What do you say about the Sharp decision
22 in that regard? There the allegation was that a bank that had
23 lent money to Mr. Sharp realized that he was insolvent,
24 realized that he was engaged in a Ponzi-like scheme, and
25 realizing that he agreed with him that he would pay back the

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1 monies that they were owed out of monies that he got from
2 future lenders who weren't in on the scheme. And the Second
3 Circuit, if I recall correctly, said it wasn't the actual fraud
4 had not been adequately pled, but in terms of constructive
5 fraud under New York law, this was an antecedent debt and the
6 other folks could have made their own inquiries. They didn't.
7 This creditor did. And the loss falls where it falls.

8 MR. SHEEHAN: I think the key phrase your Honor just
9 did in describing that is a valid antecedent debt, and there is
10 none in this case, none. It does not exist. Second Circuit
11 said so. So without valid antecedent debt --

12 THE COURT: You're talking about the decision earlier
13 this week?

14 MR. SHEEHAN: Absolutely.

15 THE COURT: Where do you see that?

16 MR. SHEEHAN: By suggesting that you cannot look at
17 the last statement and that you cannot rely upon that to
18 determine what the net equity is --

19 THE COURT: What it said was that the trustee, that
20 that was a permissible way to look at things, but that the
21 trustee had equitable authority to look at it a different way
22 in terms of how he would whack up priorities of recovery. This
23 is not the same as saying that there wasn't an antecedent debt.

24 MR. SHEEHAN: I think, your Honor, what I'm referring
25 to is this language, and perhaps I'm overstating it, but I'll

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1 give it to your Honor, on page 33 of the slip opinion.

2 THE COURT: Page 33. Go ahead.

3 MR. SHEEHAN: Actually, it's page 17. I apologize,
4 your Honor. What I'm referring to is, I just have the quote
5 here in my hand. I will get to the page.

6 THE COURT: Page 17. Go ahead.

7 MR. SHEEHAN: It's the end of the last -- before the
8 Roman numeral I where the Court says: Use of the last
9 statement method in this case would have had the absurd effect
10 of treating fictitious and arbitrarily assigned pay for profits
11 as real and would give legal effect to Madoff machinations.

12 The only potential --

13 THE COURT: But that's in the context, and I agree
14 that's an important sentence. But the previous sentence shows
15 the context. It says: The statutory definition of net equity
16 does not require the trustee to aggravate the injuries caused
17 by Madoff's fraud. Use of the last statement method in this
18 case would have the absurd effect of treating fictitious and
19 arbitrarily assigned pay for profits as real and give legal
20 effects to Madoff's machinations.

21 That's useful and supported in a sort of policy sense
22 of the argument you are making, but it's very far from saying
23 that there was, as a matter of law, no antecedent debt.

24 MR. SHEEHAN: I think it's a critical part of the
25 structure that we can put together with this decision that

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1 leads to that result. But let's just stay within the context
2 in which this was just raised. I was talking about fictitious
3 profits, \$300 million. There can be no antecedent debt with
4 regard to that and certainly that portion of the opinion stands
5 for that.

6 So that part of the opinion supports the fact that the
7 fictitious profits part of this case is a case that belongs
8 and, quite frankly, under the code. You give no value, you do
9 not get to keep the money. So in any event, that money --

10 THE COURT: Accepting that for the moment for the sake
11 of argument, that still leaves the other what, 700 million or
12 whatever --

13 MR. SHEEHAN: Where I was just going. Thank you, your
14 Honor.

15 Now we are talking about not 20 years, not 15, not 50,
16 whatever; we are talking about six. Six years is what we have
17 pled here, that during that six-year period a number of events
18 transpired. And they transpired in a way that should not be
19 looked at in isolation but should be looked at as a whole as we
20 look at this standard that we apply.

21 Let me talk about the standard a bit. I think our
22 briefs, and I am not going to repeat it, your Honor is familiar
23 with them, I think our supplemental brief establishes, and I
24 don't think there is anything to contradict it -- indeed, I
25 think otherwise and I'll explain what I mean by that -- by our

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1 adversary.

2 We went through securities law, common law, and the
3 bankruptcy law and showed a common thread through each with
4 regard to willful blindness and what that means. And they have
5 all of the same elements.

6 What our adversaries have cited in return is, they
7 abandoned -- if you recall, in their motion to withdraw the
8 reference, they embraced 10b-5. Walked away from it once we
9 pointed out that it didn't support their position and have now
10 ran to the UCC, as was argued today by my adversary. We didn't
11 get a chance to reply to that, but we did do a little research.

12 Quite frankly, the standard, the standard in the UCC
13 is the same as it was in common law, the same as it is in the
14 securities law, and it is the same as it is in the bankruptcy
15 code. And that is, is that willful blindness does not rise to
16 the level of actual knowledge in that context.

17 If I may, I'd refer your Honor --

18 THE COURT: Willful blindness. It's funny. No one
19 seemed to cite in their papers the decisions of two obscure
20 judges who you may have heard of, Learned Hand and Henry
21 Friendly, who have written extensively in the context of
22 criminal cases against accountants on what is meant by willful
23 blindness. And I'm thinking of cases like United States v.
24 Benjamin. And the common core of willful blindness is that you
25 purposely turned away from learning something because you knew

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1 there was a high probability that you would learn something bad
2 that would render improper what you were doing.

3 So, of course, I've seen other formulations in the
4 papers from both sides here, but I mention, if you go down to
5 the ninth floor of this courthouse and enter the ceremonial
6 courtroom, you will see two, and only two, busts in the entry
7 of that courtroom. One is Henry Friendly and the other is
8 Learned Hand. There is a reason for that.

9 MR. SHEEHAN: Your Honor, I apologize for not citing
10 it, but we did look up Learned Hand, and I do have a quote from
11 him that supports that notion that your Honor -- it's in the
12 Bentley v. Young, 210 F. 202 at 205, 06 in 1914 where under the
13 Bankruptcy Act of 1898, he says and, quote, personal good faith
14 is not enough. The question is not what [the transferee]
15 individually believed, but whether the circumstances would have
16 put a reasonable man in this situation upon inquiry.

17 I suggest to your Honor that that's still the law
18 today.

19 THE COURT: Your adversary is distinguishing between a
20 situation where you might have some circumstances that might
21 cause you to make some inquiries and a situation where you
22 consciously chose not to make an inquiry.

23 What your adversary, and I'm oversimplifying, but she
24 seems to suggest that she could not prevail on her motion at
25 least across the board if you were able to demonstrate either

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1 actual fraud on the part of the defendants here or willful
2 blindness. But she says she doesn't think it's enough to
3 simply show that there were sufficient circumstances to warrant
4 some inquiry.

5 So, taking that issue up, what are the circumstances
6 that you think constitute, taken most favorably to you, because
7 I must on this motion, at this conscious turning away.

8 MR. SHEEHAN: Let's deal with a couple that your Honor
9 discussed with my adversary.

10 As we often do, we speak of these things that they
11 look for Ponzi insurance. It's passed on.

12 Let's pause. Let's pause. This is the testimony of
13 the fellow, Arthur Friedman, who is running the funds for these
14 fellows. And he is involved not only in that fund, but also
15 other funds. He knows his business. And he is inquiring
16 through other people who have already purchased this insurance
17 about looking into this insurance. And he writes down, and we
18 have shown your Honor the note, Ponzi. What do you think is
19 going on in that conversation? The conversation isn't, what
20 does Ponzi mean? Maybe it is. It says, do you know what that
21 is? That's stealing other people's money and giving it to
22 other people. That's a bad thing. Gee, you think we can
23 ensure that? Would that be your first instinct? Would your
24 first instinct be do that or call Bernie Madoff and say, look,
25 I'm concerned, so concerned that I'm thinking of insuring this,

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1 but now I am not going to make that phone call. I am not going
2 to call Bernie and say, look, instead, I am going to insure it
3 rather than call him up and say I want to come down.

4 THE COURT: They may have a competing argument as to
5 why this was innocent, but taken it most favorably to you for
6 purposes of this motion, a fact finder could infer that they
7 didn't want to know whether it was a Ponzi scheme because they
8 feared it was and therefore they got insurance.

9 MR. SHEEHAN: Yes. Think about it. Not only didn't
10 they make that phone call, not only didn't they go down there
11 and say, let me see those trades and let's make sure this is
12 actually happening and you're not just moving around other
13 people's money, they doubled up. They borrowed money to put
14 more money into Madoff.

15 What's the next step? Somebody says to them, you
16 know, I think this could be --

17 THE COURT: I am not sure what inference you draw from
18 that second part of that.

19 MR. SHEEHAN: Your Honor, instead of engaging in --
20 they had a choice. That choice to make to make an inquiry and
21 find out what the Ponzi was. Instead, they let, and I think
22 this is a fair inference, greed to direct what they did. They
23 didn't look to find out what was going on and see if it was a
24 Ponzi. They doubled up to make more money out of other
25 people's money.

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1 THE COURT: Why is that a plausible inference when
2 perhaps equally plausible would be that if they knew it was a
3 Ponzi scheme or feared it was, the last thing they would do is
4 put more money in it because they never knew when the scheme
5 would come crumbling down.

6 MR. SHEEHAN: Which is always the answer everybody
7 gives in a Ponzi scheme, or else there wouldn't be a Ponzi
8 scheme. Greed dominates Ponzi schemes, not good judgment. If
9 good judgment prevailed, there wouldn't be Ponzi schemes.
10 People wouldn't put money into something that's too good to be
11 true that might be a Ponzi scheme or try to insure against it.
12 They wouldn't put their money in.

13 THE COURT: Is it your view then that every single
14 investor in a Ponzi scheme is guilty of willful blindness?

15 MR. SHEEHAN: Of course not. We filed over a thousand
16 lawsuits. Only 60 out of a thousand lawsuits constitute this
17 kind of lawsuit. The other thousand are good faith.

18 THE COURT: I'm still having trouble. If you don't
19 know it's a Ponzi scheme and you are not willfully blind to the
20 fact that it's a Ponzi scheme, then, of course, you are going
21 to put more money in because you think it's a great investment.
22 But if you know, either directly or, as you allege, under the
23 willful blindness approach, that it is most likely a Ponzi
24 scheme, there is a high probability it's a Ponzi scheme, you
25 are just not going to inquire, but you, deep in your heart,

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1 think so, you might get insurance. That I understand. But why
2 would you put more money into it?

3 MR. SHEEHAN: Because you're so intertwined. Read all
4 of the allegations of the complaint.

5 THE COURT: I did.

6 MR. SHEEHAN: They are intertwined. They are doing
7 this. You asked about the bank. Do you think you could call
8 up your broker and say, you know, I really need \$58 million,
9 but I can't go to the bank with it because I am going to end up
10 violating some covenants, et cetera. What I want you to do is
11 rig up an investment, don't worry, I'll pay you back in a
12 couple of days. That's a fair inference to draw what happened
13 with that \$58 million. That's exactly what was going on. You
14 think anybody else could call their broker and get that done?
15 I don't think so. Not a legitimate broker, not someone who
16 wasn't engaging in illegal activity.

17 Which leads to the next item. Front running. What is
18 front running? It's criminal. It's illegal. Ms. Wagner says
19 it's just they heard it might be front running.

20 THE COURT: There again, I'm not totally sure I
21 understand your argument. Front running presupposes that the
22 broker is actually investing the monies he has been given by
23 his customers, and he takes advantage of that knowledge to make
24 his own investments in advance in order to get some special
25 benefits in violation of his fiduciary duties to his customers.

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1 So assuming they feared he was front running, that
2 would show that they were confident that he was actually
3 purchasing securities for his customers.

4 MR. SHEEHAN: It's not actual suspicion, your Honor.
5 That's not the standard. As Judge Sweet pointed out in Credit
6 Bancorp involving the UCC, it's not actual suspicion. It's
7 whether or not those facts would give rise to suspicion. And
8 if you are told --

9 THE COURT: Let me make sure. If you had heard a
10 rumor that your broker was front running, first, you might say,
11 well, I don't care because he is still making a ton of money
12 from me, or, you might say, I don't care because those kind of
13 rumors are endemic to the marketplace. But assuming you felt
14 the need to make an inquiry, what is the specific inquiry you
15 would make at that point?

16 MR. SHEEHAN: I think you would go down and ask to see
17 the trading operations, see the trade, see what's going on to
18 make sure that they are not running in front of your orders.
19 It's not a very difficult task to do, especially when you're
20 doing what they are doing in terms of being involved in your
21 own hedge funds and doing other things.

22 THE COURT: If you wanted to detect front running, the
23 last thing you would do is call up your broker and say, I want
24 to come down and watch your trades. Even if he was front
25 running, the last thing he is going to do is front run while

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1 you're there. He will wait until you're gone.

2 MR. SHEEHAN: That's not that easy to hide, for one
3 thing, because you could look at prior transactions and see the
4 timing of the trades. He wasn't exactly talking about sitting
5 in the trade room and watching the trade. I'm not that naive,
6 your Honor. I'm suggesting he would go down and look at prior
7 trades. You could look at prior trades and see that. That
8 wouldn't be that difficult.

9 THE COURT: If in this case you went down, you would
10 say show me the records of prior trades, yours and mine, and he
11 would have, consistent with his modus operandi, given you his
12 phony statements about your prior trades and he would say, and
13 I didn't trade at all, then you would be perfectly satisfied
14 that he wasn't front running.

15 MR. SHEEHAN: I guess when your clients -- the
16 inference your Honor is suggesting is, when they are engaged in
17 criminal activity, if I can't find out, there is no sense
18 looking.

19 THE COURT: No. I'm saying that you are trying in
20 this suspicion of front running a duty of inquiry that would
21 not have revealed and wasn't intended to reveal and would not
22 have revealed anything about his having a Ponzi scheme, or at
23 least it's not clear how it would.

24 MR. SHEEHAN: I don't have to prove that it was a
25 Ponzi scheme or that they thought it was. What I have to prove

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1 is --

2 THE COURT: You just have to prove that they in some
3 vague way were engaged in improper activity?

4 MR. SHEEHAN: No. Not some vague way. I think far
5 from being vague. We give very, very specific and detailed
6 allegations with regard to all of this. There was enough
7 activity surrounding this, whether it be illegal criminal front
8 running, whether it be the fact that they had rumors and looked
9 into the fact that it might be a Ponzi scheme, that they could
10 effectuate loans and transactions that in the normal brokerage
11 world never happened, that they in fact doubled up and did
12 things that indicated that their whole financial empire was
13 tied into this organization.

14 All those things put together, put together, put them
15 on suspicion that something here wasn't quite right and that
16 they had to look in. But they didn't do that. That's where
17 willful blindness comes in. Willful blindness describes
18 conduct, conduct in the sense that when you have that litany in
19 front of you, those things that are wrong, that you have at
20 that point an obligation to do one of two things, either look
21 into it or get out. They didn't do it and they stayed in.

22 What does that mean? What are the implications for
23 staying in when you should have looked. When you should have
24 looked, you are then charged. It's imputed to you. Or you
25 knew those things or you would have found those out or you

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1 would have been led to those. In this stage of proceeding we
2 are entitled to all those inferences in this particular case.

3 THE COURT: If it's a motion to dismiss, you are
4 entitled to every plausible inference that arises from your
5 pleadings as long as it's more plausible than the competing
6 inference. If it's a summary judgment motion, you're entitled
7 to every reasonable inference based on the admissible evidence.

8 MR. SHEEHAN: Right.

9 THE COURT: What I'm unclear on is what specifically
10 are the allegations, either well pled or supported by evidence,
11 whether it was a motion to dismiss or summary judgment, that
12 supports what you and your adversary agree is the sine qua non
13 of conscious avoidance, which is the conscious part, the
14 turning away. And I think you have made an interesting point
15 with respect to the fraud insurance, and I want to hear from
16 your adversary. I'm not as persuaded, I think, by the front
17 running thing. And then you were in the process of telling me
18 some others.

19 MR. SHEEHAN: Well, I'm a little troubled by your
20 Honor's use of the phrase conscious avoidance. We are not
21 talking about aiding and abetting. I think the law is clearly
22 the bankruptcy code and that's what applies here. And, again,
23 I go to the Second Circuit and you look at footnote 11. What
24 they are talking about there is this. What is the protection
25 afforded by the statute?

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1 THE COURT: Footnote 11.

2 MR. SHEEHAN: Footnote 11. It's on the next to last
3 page of the opinion, I believe, your Honor. It's on page 34.
4 As the Second Circuit and as Judge Lifland also noted, it
5 starts off with --

6 THE COURT: I was going to say, it's a very long --

7 MR. SHEEHAN: I am going to just pause and work my way
8 through it. I will go as quickly as I can. It says a SIPA
9 liquidation is a hybrid proceeding. Last time we were here
10 your Honor wondered allowed as to what protection is afforded
11 by this statute. And the allusion might have been and could be
12 suggested that perhaps there should be a different standard
13 applied here. We are in a brokerage setting dealing with
14 securities. But clearly that's not the case. The protection
15 afforded by the statute is the creation of a fund, a customer
16 fund, a fund in which cash and securities are held by the
17 broker. When it goes out of business it's the duty of the
18 trustee to reconstitute that fund, to put it back together
19 again.

20 So all those who were harmed by the wrongdoing of that
21 broker get their money back and when you're in a Ponzi scheme
22 that means only one thing. It means getting the money from
23 other customers and putting it in the fund.

24 So how do you go about doing that? What does the
25 statute tell us? This is that's the other half of the hybrid

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1 statute. It tells you that you use the full panoply of Title
2 11 that allows a trustee to go out there, not just using
3 preference, but using fraudulent conveyance laws that let you
4 go back two years under 548, let's you go back into the states
5 and utilize their rights, going back six years, which is what
6 we have done here, and that those two are so consonant, they
7 work together, the remedial purpose of the statute and the
8 utilization of the full powers of the trustee.

9 THE COURT: First of all, I'm glad you called my
10 attention to footnote 11 because the way I read it, which is
11 undoubtedly a self-serving way, is strongly supportive of my
12 decision in the HSBC case. But putting that aside --

13 MR. SHEEHAN: I respectfully disagree, but I feel
14 compelled to say so.

15 THE COURT: We can have that argument another time.

16 MR. SHEEHAN: I would love to.

17 THE COURT: What I don't see is where it bears on the
18 question I was raising with you a second ago. There are three
19 possible approaches here so far as what you might call the
20 mental state of the defendants. And there is this big debate
21 which your adversary had alluded to as to one of those prongs.
22 But both sides agree that one way to go back is if there was
23 actual fraud. Both sides agreed that another way to go back is
24 if there is conscious avoidance, willful blindness. These are
25 all terms that Model Penal Code which is actually the origin

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1 for a lot of this and attempted to regularize it many years ago
2 talks in terms of recklessness. But they all have a conscious
3 element. And the conscious element is essentially what is
4 sometimes referred to as the ostrich element, the I don't want
5 to know what's out there, even though there are red flags
6 flying all over the place, don't tell me because I want to
7 pretend I don't know.

8 And then there is the third aspect which your
9 adversary says doesn't apply here and you says does apply here,
10 which is whether you have a duty of inquiry, regardless of
11 whether those red flags fly, whether under certain
12 circumstances you would have to undertake due diligence. One
13 can think of, again, many synonyms. But we are focusing for
14 the moment on the willful blindness part.

15 MR. SHEEHAN: I'm suggesting it doesn't fly, that the
16 Second Circuit tells you, you're working on inquiry notice
17 here. You're operating --

18 THE COURT: That's a separate argument. Forgive me.
19 I don't want to shift from one to the other until I hear your
20 answer --

21 MR. SHEEHAN: My answer on the other is that that's
22 not the law in this setting on the allegations we have pled.
23 Conscious avoidance fits into aiding and abetting, somebody who
24 is collusive with somebody else, none of which we have alleged
25 here. Those allegations aren't in our complaint. Tearing down

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1 allegations that don't exist is one thing, but they don't, so
2 they are not here.

3 THE COURT: But my understanding is that you had
4 alternative theories here. One was, duty of inquiry. The
5 other was willful blindness. And all I wanted to do -- I
6 assume you're not abandoning the willful blindness.

7 MR. SHEEHAN: I think I could prove it.

8 THE COURT: That's what I was trying to get from you
9 before we moved to the --

10 MR. SHEEHAN: I don't think I have to prove it to win
11 the case.

12 THE COURT: Here is your choice. You can either
13 abandon it or you can tell me how you can prove it, but you
14 have to pick one or the other.

15 MR. SHEEHAN: I don't think I do, because I don't
16 think -- your Honor is suggesting this. Let me explain why I
17 say that, your Honor. I'm not being facetious. I'm really not
18 trying to be. I think willful blindness has gotten a bad name.
19 I think it's been -- it's got a lot of things hung on it that
20 don't hang together. For example, when I mentioned Judge
21 Sweet, and if I could be so bold as to refer to that opinion
22 again --

23 THE COURT: One of the very greatest judges on this
24 Court.

25 MR. SHEEHAN: One of my favorites. Even though I lost
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1 in front of him last year, but those things happen.

2 In any event, it's in 2003. The citation is 279
3 F.Supp.2d at 247.

4 THE COURT: What's the name of the case?

5 MR. SHEEHAN: The name of the case is the Securities
6 and Exchange Commission v. Credit Bancorp Limited.

7 THE COURT: And is this cited in your brief?

8 MR. SHEEHAN: No. It was not and I apologize, your
9 Honor. But this issue of relying upon the UCC as another place
10 where the standard is different and therefore should be applied
11 only arose in the apply briefs, so we did do our research, and
12 I apologize for that.

13 THE COURT: Did you tell your adversary before we came
14 down here that you were going to cite this?

15 MR. SHEEHAN: I probably didn't, no.

16 THE COURT: Go ahead then, but I will then, of course,
17 let your adversary, if she hasn't read it, put in a letter
18 brief.

19 MR. SHEEHAN: I'll expect nothing less, your Honor.
20 Of course.

21 What they are talking about here is, this is under the
22 UCC, which my adversary relies on suggesting that willful
23 blindness raises to the level of conscious disregard, as your
24 Honor has suggested, and this is Judge Sweet and I'm reading
25 from page 264. The first prong of the willful blindness test

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1 "turns on whether the person is aware [of] sufficient to
2 indicate that there was a significant probability that an
3 adverse claim exists," cites official comment for UCC Section
4 8-105. Whether the person is aware "necessarily turns on the
5 actor's state of mind," ID.

6 That means, however, that the individual need only
7 have actual awareness of the facts giving rise to the
8 suspicion. Actual suspicion is not necessary. The words here
9 used are not conscious disregard. They are talking about
10 suspicion, which is much more akin, I suggest to your Honor, to
11 the standard that is utilized in inquiry notice. That is, you
12 have a suspicion. You're put on inquiry. You should go look.

13 So, therefore, when I say willful blindness gets a bad
14 name, if I could just finish, your Honor, what I mean by that
15 is this. People then hang on with conscious disregard and in
16 some settings it might be utilized that way. But in this
17 setting, what we are talking about here and the allegations we
18 have made in what we have pled, what we were talking about is
19 this. As your Honor said, they turned a blind eye. But what
20 was meant by that is, they had suspicion, inquiry notice, they
21 knew things were going on, they decided not to look. And that
22 failure to act has consequences. We are not suggesting
23 conscious disregard.

24 THE COURT: I am concerned that you have conflated in
25 a way that perhaps the law will permit you to do inquiry notice

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1 and willful blindness. But, in any event, I understand your
2 position. Let's move on.

3 MR. SHEEHAN: As your Honor said the last time we were
4 together, brilliant minds like Friendly and Hand dealing with
5 that issue and wrestling with it, so the fact that I'm
6 wrestling with it, too, shouldn't be surprising.

7 In any event, your Honor, at the end of the day I
8 believe that -- if we can return to footnote 11, and I just
9 want to pursue this very briefly. I know we have been going a
10 while. And it says at the beginning -- I'm looking just in the
11 middle. Starts in the very extreme right: As the bankruptcy
12 court ruled, "SIPA and the [B]ankruptcy [C]ode, intersect, has
13 an ellipsis, to grant the SIPA trustee the power to avoid
14 fraudulent transfers for the benefit of customers. Cites the
15 lower court case.

16 The objecting BLMIS claimants point out that no
17 avoidance power has been invoked in this case. True. However,
18 in the context of this Ponzi scheme, the net investment method
19 is nonetheless more harmonious with the provisions of the
20 bankruptcy code that allow a trustee to avoid transfers made
21 with an intent to defraud and avoids placing some claims
22 unfairly ahead of others, citing both Section 548 and the
23 decision, very excellent decision by Judge Marrero in the Adler
24 Coleman case, which, by the way, totally rejects the
25 application of 546(c) in the Ponzi setting. Let me get to that

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1 in a minute.

2 What we have here is, we have a Second Circuit
3 decision, looking at the very facts of this case and saying, on
4 the one hand, the trustee has a right. He used his discretion
5 correctly under the terms of the statute to decide how we are
6 going to determine that equity. And not only is it right in
7 terms of the fairness under a Ponzi scheme of getting the money
8 back from the people who don't have it, but on top of that,
9 it's perfectly consonant, as Judge Lifland also found, with the
10 statute of Title 11 and the bankruptcy code and, therefore,
11 that would suggest to me in their citation of Adler Coleman in
12 Section 548 tells you that what they are saying is they embrace
13 inquiry notice, that what we are alleging here is the way this
14 case should proceed.

15 It shall proceed according to -- while this may be
16 supportive of your Honor's HSBC decision, what I'm saying is is
17 that it proceeds under the bankruptcy code utilizing all of
18 those avoidance powers to bring that money back and
19 reconstitute the fund. And that's exactly what we are doing
20 here. It's exactly what we are doing. We are saying, \$300
21 million of fictitious profits has to come back because it's
22 other people's money.

23 We are also saying that when you have the panoply of
24 notice that we have here, it easily fulfills the standard of
25 inquiry notice. Certainly, at this stage of the proceeding,

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1 notwithstanding what my adversary says, we have had minimum
2 discovery, some under 2004, no question about it. Not going to
3 deny it. We had it. It was there. We took depositions, we
4 got documents. We got like 5,000 e-mails. In the world of ESI
5 today, your Honor, it's a drop in the ocean. We barely got
6 started. We have got a lot more to do. And under the terms of
7 the Second Circuit decision here, we should be empowered, this
8 trustee should be empowered to pursue those actions under 548
9 using the standard of inquiry notice and that we have pled more
10 than adequately enough for us to go forward doing that.

11 One other point, your Honor and I'll sit down. 546.
12 Your Honor asked the absolute correct question. What was the
13 purpose of that statute? It's been talked about ad nauseam. I
14 think it's very telling that my adversary in their brief, this
15 last brief, cited one case, the recent Enron case. I don't
16 think we have to talk about that here because we don't have any
17 security here. It was a very important fact.

18 By the way, as I said last time I was here, I think
19 Judge Koeltl had the better of that argument anyway.

20 But the bottom line is this, is 546 was supposed to
21 intervene in markets to stop the ripple effect, started with
22 LBOs, then got into derivatives, as my adversary says. It's
23 supposed to deal with real markets in real time to prevent the
24 ripple effect of going out there. Every case, and we cited
25 four or five of them, they are in our brief.

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1 THE COURT: You're saying it never was intended to and
2 shouldn't be read to apply to a wholly fictitious situation.

3 MR. SHEEHAN: We are talking about a fictitious
4 market, your Honor. It never existed. It couldn't have a
5 ripple effect if it tried.

6 THE COURT: Let me hear from counsel for SIPC.

7 MR. LaROSA: Just a couple of remarks, your Honor. I
8 want to emphasize Mr. Sheehan's view that the Second Circuit --

9 THE COURT: That's because you felt he was so shy and
10 quiet.

11 MR. LaROSA: That's right.

12 I wanted to emphasize that the Second Circuit's net
13 equity decision earlier this week, we think, bears critically
14 on this case and in fact it's footnote 11 that's of particular
15 relevance. Again, the Court did emphasize -- first let me go
16 back.

17 The only way in our view that the defendant
18 transferee's state of mind is relevant here legally is in the
19 context of the good-faith standard that occurs in the
20 bankruptcy code, which is a defense to intentional fraudulent
21 transfer, and in the context of good faith under the New York
22 DCL. The fact that there is a different standard under the UCC
23 perhaps, or perhaps not, has no bearing on the case because in
24 fact there is no claim that's been brought under the UCC and
25 neither the bankruptcy code nor the New York DCL recognized the

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1 UCC as being a possible defense to a claim brought under the
2 bankruptcy code or the New York DCL.

3 In fact, in footnote 11, the Second Circuit emphasized
4 the importance of Title 11 in the context of a SIPA
5 liquidation. It stated, among other things, that the SIPA
6 trustee has the power to exercise the bankruptcy code avoidance
7 powers to, quote, avoid placing some claims unfairly ahead of
8 others. And it said this in the context -- it went on to say
9 that the net investment method would be more harmonious with
10 the bankruptcy code's fraudulent transfer provisions than the
11 last account statement method. If you actually unpack that a
12 little bit, you can see how that bears critically on this case.
13 The last account statement method would have given recognition,
14 would essentially --

15 THE COURT: Just so we are clear about footnote 11,
16 the first part of footnote 11 talks about that the statutory
17 provisions that a trustee shall be vested with the same powers
18 as a trustee in a case under Title 11, and no one disputes
19 that. The portion that you are referring to says that in the
20 context of this Ponzi scheme, the net investment method is
21 nonetheless more harmonious with provisions of the bankruptcy
22 code that allow a trustee to avoid transfers made with the
23 intent to defraud and "avoids placing some claims unfairly
24 ahead of others," quoting there the decision in *In re Adler*
25 *Coleman Clearing Corporation*.

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1 So what is being said there is that of the available
2 methods that were available to the trustee to deal with various
3 priorities and preferences -- priorities, I should emphasize.
4 His choice of the net investment method was more consonant with
5 or, as the Court says here, more harmonious with provisions of
6 the bankruptcy code than some other methods that the appellants
7 were arguing should apply.

8 I don't see how that says anything about the issue we
9 have just been discussing.

10 MR. LaROSA: It says a lot about the trustee's ability
11 to bring fraudulent transfer claims to recover payments made in
12 connection with a securities customer's account. That's
13 exactly what's going on here.

14 THE COURT: Where was the question of choices where
15 the trustee had the discretion, subject to approval of the
16 bankruptcy court and ultimately the Court of Appeals, to choose
17 between different methods of its discretion to pick this one in
18 this case, in the view of the Second Circuit, was more
19 harmonious with the policies of the various bankruptcy
20 provisions than otherwise. That was the issue there. The
21 issue here is what the law permits or doesn't permit. It's not
22 a question of discretion at all.

23 MR. LaROSA: The reason why the Court, I believe,
24 believed that the net investment method is more harmonious is
25 because the last account statement method, if applied in this

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1 case, would, in effect, prohibit the trustee from bringing any
2 fraudulent transfer to recover transfers made --

3 THE COURT: That says nothing about whether particular
4 claims are proper or improper.

5 MR. LaROSA: What it does say, though, is a trustee --
6 the defendant's position here is that because they had or what
7 they had what they believed to be securities contracts, which
8 reflected certain promises made to them by the broker/dealer,
9 the trustee is precluded from attempting to recover any
10 transfers that were made in connection with those securities
11 contracts, and this is in different contradiction to that.

12 THE COURT: Isn't your argument there the one that I
13 just heard Mr. Sheehan say, unless I misunderstood him, is that
14 provision doesn't apply because these are not really security
15 contracts, these are fake contracts?

16 MR. LaROSA: We don't think they are security
17 contracts.

18 THE COURT: But not because of anything in footnote
19 11.

20 MR. LaROSA: The point is is that the Second Circuit
21 is giving recognition to the fact that even where a claimant
22 has received what amounts to a promise from a broker/dealer
23 saying, you are owed XYZ securities and a certain amount of
24 cash and receives a withdrawal transfer, what purports to be a
25 withdrawal transfer in connection with that promise, that does

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1 not prevent the trustee from bringing a fraudulent transfer
2 suit to recapture those amounts. That's exactly what the
3 defendants are saying here. They are saying, we had a
4 contractual arrangement with the broker/dealer. And because --

5 THE COURT: I understand that as an argument and it
6 may be a winning argument, I don't know, but I don't see
7 anything in footnote 11 that says about that one way or the
8 other.

9 MR. LaROSA: I guess we would disagree with you there,
10 your Honor.

11 It's also important --

12 THE COURT: Not the first time.

13 MR. LaROSA: Mr. Sheehan also, I think, alluded to the
14 citation to Adler Coleman. We think that also has important
15 bearing.

16 THE COURT: That's a different issue and I will
17 certainly take --

18 MR. LaROSA: We think it's rather the same issue.
19 It's somewhat the same issue. This is a case --

20 THE COURT: All I meant is, I will take another look
21 at that opinion, but both of you have emphasized what you
22 consider to be supportive. It's not binding on me.

23 MR. LaROSA: I understand it's not binding on you,
24 although it's been cited with approval by the Second Circuit.

25 THE COURT: I'm with you that I should take a close

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1 look at it.

2 MR. LaROSA: The circumstances there are quite
3 parallel to what's going on here. There Judge Marrero held
4 that fictitious trades that were purportedly made in the
5 accounts of customers of the broker/dealer in liquidation under
6 SIPA did not create enforceable contracts, that those trades
7 were subject to revision and avoidance by the trustee pursuant
8 to the fraudulent transfer laws, and that's exactly what's
9 going on here. We think the same result should be achieved.

10 THE COURT: Thank you very much.

11 MR. LaROSA: Let me make a couple of other points.

12 With regard to 546(e), there was, I think, a
13 distinction made. I think your Honor may have drawn it between
14 plain language and purpose. And we actually think that the
15 plain language doesn't support the application of 546 here
16 either. Because there was no securities trade of any kind,
17 there was no settlement payment in connection with the
18 securities trade that could have been made. Just under the
19 plain language of 546 --

20 THE COURT: Let me just take you up on that.

21 Supposing I enter into a contract with you for you to supply
22 some third party with so many widgets and I give you a thousand
23 dollars and you are supposed to supply \$900 of widgets to a
24 third party and keep the \$100 as your commission, and you don't
25 do that. You keep all thousand dollars. Are you saying I

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1 can't sue for breach of contract because I don't have a
2 contract?

3 MR. LaROSA: It depends on whether or not there was a
4 meeting of the minds. Your Honor has said in the context --

5 THE COURT: The meeting of the minds, of course, is a
6 question of the words in the contract. It's an objective
7 standard, not a subjective standard.

8 MR. LaROSA: Well, your Honor has said in the context
9 of the HSBC situation that no bailment could have arisen
10 because BLMIS was a thief. We think that's incorrect because
11 we think Rule 15(c)(3)(3) imposes a contract by operation of
12 law, irrespective of law, but let's assume that it is correct,
13 the fact that Madoff wasn't a thief, didn't have the intent
14 ever to dispose of the assets being entrusted to him in the way
15 that was intended would prevent the formation of the bailment.
16 Isn't that the same thing?

17 THE COURT: I think the law of bailments and the
18 law --

19 MR. LaROSA: It's a bailment contract.

20 THE COURT: My question to you is, in my hypothetical,
21 are you saying that the person who paid over the thousand
22 dollars to get the second person to deliver the widgets could
23 not sue the second person for breach of contract when he
24 learned that the person had kept all thousand dollars and never
25 got all the widgets?

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1 MR. LaROSA: I am not sure, your Honor. I think at a
2 minimum there would be a suit for fraudulent inducement.

3 THE COURT: Unless my contracts professor in law
4 school misled me, I think that would be a classic case for a
5 breach of contract lawsuit. I don't see how you can seriously
6 pretend it wouldn't be, that such a lawsuit would fly in such a
7 situation. You may convince me that I'm wrong. I'll then have
8 to go back to law school.

9 You had some other points you wanted to make.

10 MR. LaROSA: We think also 546(e) doesn't apply here
11 because it would impair and impede the effect of administration
12 of SIPA. And in fact this is also what's echoed or what is a
13 part of the Second Circuit's opinion. Second Circuit's opinion
14 acknowledges again, in footnote 11 that, again, cites the Adler
15 Coleman case for this proposition, that one of the purposes of
16 SIPA is to ensure quality treatment among customers. You don't
17 want to put some claims unfairly ahead of others. And the
18 application -- and, again, it acknowledges that the fraudulent
19 transfer laws are one of the appropriate vehicles that enable a
20 trustee to do that. And so let's assume arguendo that a
21 contract was formed, 546(e) is part of the bankruptcy code.
22 The bankruptcy code applies in these proceedings only to the
23 extent that they are consistent with SIPA. SIPA, one of its
24 core goals is to ensure the equality of treatment among
25 customers. That's why there is a rateable distribution of

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1 customer property.

2 THE COURT: I'm surprised you didn't make the
3 following answer to my hypothetical, which I will raise because
4 I want to hear from your adversary. If you know from a course
5 of dealing or if you have purposely turned away from learning
6 because you deeply, deeply suspect that the person you are
7 dealing with on contract after contract is pocketing that
8 thousand dollars and then you enter into a new contract for a
9 thousand dollars, that may not be an enforceable contract. You
10 are there, it's a very different situation from the one I
11 posited in the abstract in my hypothetical. So that's the
12 argument --

13 MR. LaROSA: That's why I said I didn't know, your
14 Honor.

15 THE COURT: I want to hear what your adversary says to
16 that. I interrupted you. I'm sorry.

17 MR. LaROSA: I just wanted to make a point that it
18 seems clear to us from the Second Circuit's opinion from Adler
19 Coleman, from the other authorities that we have cited that the
20 application of 546(e), it would be inconsistent with its
21 statutory purpose, certainly wouldn't further that statutory
22 purpose, but also would conflict with SIPA's core statutory
23 purpose, which is to ensure the equality of treatment among
24 customers. And if you allow some customers to hang on to 100
25 percent of property that they would otherwise have had to share

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1 but for these fraudulent transfers with all of the customers of
2 the entity, you are contravening the core purpose of the
3 statute.

4 THE COURT: Thank you very much. Let me hear rebuttal
5 from counsel for the movants.

6 MS. WAGNER: Thank you, your Honor. I guess I should
7 go directly to your hypothetical. It is certainly our view
8 that if a customer is willfully blind and knows that the
9 customer is investing in a Ponzi scheme, it's unlikely that we
10 would have a meeting of the minds that this was a securities
11 contract, so I will certainly admit that.

12 THE COURT: It again comes down to the main point
13 you're sort of resting on, not exclusively by any means, that
14 you agree that you're in trouble, so to speak, on these claims
15 if they can prove willful blindness, but you're saying they
16 can't. And you are saying as to their softer position being
17 inquiry notice, that doesn't apply to your situation.

18 MS. WAGNER: That's exactly what I'm saying, your
19 Honor, and I am saying one more thing, which is that they have
20 not proven that. There was some colloquy here about your
21 reviewing the facts in the complaint most favorably to the
22 plaintiff. Your Honor, I would suggest to you that that is not
23 appropriate in this case. We have fully briefed the motion for
24 summary judgment. They have not objected to that whole
25 process. They have certainly not made any showing that --

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1 THE COURT: I think they have objected in the sense,
2 my recollection is they said that at a minimum I should not
3 allow that without allowing them further discovery.

4 MS. WAGNER: They did say that, your Honor. But they
5 did not meet, by a long shot, the rules, Rule 56 rules for
6 demonstrating what discovery they needed. The only thing I
7 have heard today is they need more than 5,000 e-mails. There
8 is no evidence whatsoever there are more than 5,000 e-mails.
9 There is no evidence anyplace here that they need anything.
10 They have got the testimony of all the actors involved here.
11 They have more testimony --

12 THE COURT: Anyone who owns a computer knows there is
13 always more than 5,000 e-mails on any subject under the sun.

14 MS. WAGNER: Your Honor, you sort of put your finger
15 on something which you're assuming that we are all living in
16 the 21st century.

17 THE COURT: Go ahead.

18 MS. WAGNER: Anyway, your Honor, I would very strongly
19 urge you to review the transcript of this hearing today and
20 compare it to the evidence that's in the record before you.
21 Some of the things that were being said to you today about
22 shopping for fraud insurance, they are not in the complaint,
23 let alone being in the evidence that's before this Court.
24 Nothing of the sort ever happened. And the evidence is in
25 front of you. Similarly, your Honor --

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1 THE COURT: Let's dwell on that because I think --
2 your adversary said, and I must admit that I couldn't remember
3 this from the complaint, that you shop for fraud insurance and
4 specifically for Ponzi insurance and why would you do that if
5 you didn't think it was a Ponzi scheme? Are you saying that's
6 not in the record at all?

7 MS. WAGNER: What is in the record, your Honor, is
8 that somebody came to Sterling and said, I got some insurance,
9 I think it covers Madoff, you should look at it. It covers a
10 lot of things, but I think maybe Madoff, too. You might want
11 to think about it. He is a friend of the group and he said, go
12 see what it is.

13 THE COURT: What did he say about the nature of the
14 insurance?

15 MS. WAGNER: It was fraud-based broad coverage.

16 THE COURT: Has anyone been deposed on this issue?

17 MS. WAGNER: Your Honor, our clients have been deposed
18 on this issue. We believe others have been, but we don't know.

19 THE COURT: Just tell me what you know.

20 MS. WAGNER: I'm telling you what I know. What I'm
21 telling you is what the testimony that I know about is.

22 THE COURT: Did your adversary anywhere in their
23 papers reference any other testimony other than yours?

24 MS. WAGNER: Your Honor, there were references in the
25 reply brief on the motion for summary judgment, as I recall, to

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1 things that I was not aware of and I am still not aware of in
2 terms of the testimony. I don't have it right in front of me,
3 but I can report on our own testimony. And our own testimony
4 is that he deposed our client and he asked -- not Mr. Sheehan,
5 I think one of his colleagues -- he asked, what about this.
6 And Arthur Friedman who, by the way, certainly wasn't running
7 any funds whatsoever, Arthur Friedman said, yeah, I remember, I
8 remember I wrote down on a piece of paper Ponzi, but I didn't
9 know what it was, and I don't even know now what it was. Did
10 you buy the insurance? No, I didn't buy the insurance. Didn't
11 think we needed it. Do you know if your friend bought the
12 insurance? I have no idea. That was completely misrepresented
13 in the statements today.

14 More importantly, the whole thing is crazy. Why would
15 somebody put \$500 million at risk and instead of taking the
16 money out, go and look for insurance? It is not plausible. It
17 is not a plausible approach.

18 THE COURT: Your adversary says that it was
19 essentially a hedge bet, that they were saying, we think that
20 the scheme is going to continue and we will continue to make
21 these huge profits, but in case we are wrong we will be
22 protected by this insurance.

23 MS. WAGNER: That is what my adversary said, your
24 Honor. That is not supported by the record. All I'm
25 suggesting to you is, this is a case where there is a summary

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1 judgment record and you should look at it before you assume
2 that what is said in the complaint or in this proceeding today
3 is accurate.

4 THE COURT: Of course.

5 MS. WAGNER: Your Honor, there was also a big
6 discussion about the \$54 million. Why didn't you go to Madoff?
7 We couldn't go to the bank. We would breach our covenant.

8 The testimony is, the bank had already agreed to
9 provide the money and it was just a timing question. So,
10 again, the record is before the Court and I urge you to look at
11 it.

12 This discussion that my adversaries have been having
13 with you about willful blindness, we have put before the Court
14 all kinds of cases that demonstrate maybe it's not --

15 THE COURT: On his theory, the three-part division
16 that you quoted earlier from New York State law would make no
17 sense. It would only be two parts because he is saying that
18 willful blindness is just another variation on inquiry notice.

19 MS. WAGNER: I would suggest to your Honor --

20 THE COURT: I'm certainly not deciding anything today
21 on any issue, but I confess I'm a little skeptical of his
22 argument in that regard. I'll hear anything further he has to
23 say in a second.

24 Go ahead.

25 MS. WAGNER: Your Honor, I think there are any number
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1 of cases that would tell you it's a different standard from
2 inquiry notice.

3 To the extent that the UCC rules suggest that there is
4 some duty of inquiry is only something that is imposed by
5 statute of regulation and that is not --

6 THE COURT: Their point, both the representative of
7 SIPC and the representative of the trustee, say bankruptcy law
8 trumps here because bankruptcy law, in their view, is the one
9 that imposes the inquiry notice standard. So the rest is
10 neither here nor there, in their view. So that's a separate
11 argument from the one we are discussing now. But that is their
12 most fundamental argument.

13 MS. WAGNER: That is their most fundamental argument,
14 and I would suggest to you that you only get to that argument
15 if you can plead and prove a fraudulent conveyance claim in the
16 first place. That is why we are harping on the point that if a
17 customer has a securities entitlement, that is an antecedent
18 debt and payment on the antecedent debt under the Sharp case
19 and its progeny is simply not avoidable. So they have to go
20 back and say that there was something wrong with the securities
21 entitlement, and the only way they can do that is by showing
22 willful blindness. That is why we say willful blindness is
23 necessarily the standard.

24 Your Honor, finally --

25 THE COURT: You want a chance to respond in writing to
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1 that case that they cited for the first time?

2 MS. WAGNER: Credit Bancorp. No. I think I can
3 address it, actually.

4 In Credit Bancorp, the situation was that a lender who
5 had taken a security interest in a particular securities
6 entitlement, a person in the bank knew both that he had a
7 securities entitlement and had a security interest in certain
8 securities and a security entitlement and knew also that
9 somebody else claimed them. And the court said, this was all
10 sitting in front of you, you decided to carry on. You just
11 ignored this stuff. So your securities entitlement is going to
12 be invalidated. That is a completely different situation from
13 anything here, which is where somebody had in front of him
14 certain pieces of information and didn't bother to pursue it.
15 There was no suggestion in that case that any duty of inquiry
16 arose until the person turned away from the information that
17 someone else had an interest in the securities that he was
18 claiming. So I think that is an entirely different case, your
19 Honor.

20 Your Honor, just briefly, to touch on the whole
21 front-running issue, obviously, Madoff was not front running.
22 If he was front running, we wouldn't be here today. And if
23 some newspaper article said maybe he was front running, the
24 evidence again before you is it was discussed between our
25 clients and other people and they concluded there was no front

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1 running and, in fact, one of the people with whom they spoke
2 about the front running testified that he thought Madoff was
3 one of the most honorable men he had ever met and that's what
4 he told us. It's a complete red herring in this case to
5 suggest that front running has anything to do with this case.

6 Finally, your Honor --

7 THE COURT: I do think that it may not be the
8 strongest argument on the trustee part to talk about rumors
9 that may have been in the media because part of the, if you
10 will, role of the media is to bring to light, to use the phrase
11 of the Wall Street Journal, what's heard on the street, which
12 sometimes is accurate, sometimes is inaccurate. And so I don't
13 see why any rumor that's floating around creates a duty of
14 inquiry. I'm very skeptical of that.

15 I guess I'm oversensitive to this because in today's
16 New York Law Journal, a publication for which I have a very
17 greatest respect, on the front page it described an opinion of
18 the Second Circuit saying that the majority was by Judge Raggi
19 and Judge Jacobs and that Judge Rakoff dissented.
20 Unfortunately, the majority was Judge Rakoff and Judge Raggi
21 and it was Judge Jacobs who dissented, but details, details.
22 But I can't help thinking about that. Go ahead.

23 MS. WAGNER: We would share that view, your Honor.

24 Finally, your Honor, to talk to the Second Circuit
25 decision, I already talked about it at some length. I would

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1 suggest again it certainly doesn't say anything about the fact
2 that customers don't have antecedent debt. I think the circuit
3 is very careful to say that customers did rely on their
4 statements. They are customers because of their statements.
5 Their net equity priority claim is going to be determined in
6 some particular way, but that does not mean they don't have a
7 claim.

8 I would also suggest, your Honor, that the focus on
9 this footnote is somewhat misplaced.

10 First of all, the while case and the whole footnote
11 has to do with how to allocate the fund of customer property in
12 the SIPC fund.

13 Secondly, just to discuss Adler Coleman, Adler Coleman
14 was a situation in which a broker -- that had imposed upon the
15 broker right before the filing trades that gave it an
16 obligation. And the customers were seeking to enforce that
17 obligation in a claim against the SIPC fund. And so in that
18 context Adler Coleman said, you don't have a right to this, we
19 are going to avoid the obligation because it was a fraudulent
20 obligation imposed right before the filing. There were a
21 number of trades. Most of them there was no confirmation at
22 all, so there was no writing. It's a completely different
23 case, but it's very consistent with the circuit's view, I
24 believe, that what they were trying to do is protect the fund
25 from false claims that were put on right before the filing in

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1 order to get SIPC coverage. I would suggest to you this
2 footnote is entirely irrelevant to the issue which is before us
3 today, which is, what are the standards that are applicable
4 when the debtors are suing customers.

5 THE COURT: Thank you very much. Let me give a final
6 opportunity to counsel for the trustee, because I'm scared not
7 to.

8 MR. SHEEHAN: I've accomplished something today.

9 In any event, your Honor, if I may be so bold at this
10 late hour to share with you an anecdote. It may be possible,
11 it may be true. But the origin of the term turning a blind eye
12 or willful blindness involves Horatio Nelson, who is widely
13 known to have lost his eye in battle.

14 Before he was admiral of the fleet, he is captain of a
15 ship. He's engaged in a major battle. He has lost his eye
16 already. And the admiral of the fleet asked him to retreat and
17 signal. One of his colleagues turns to the Horatio and tells
18 him that, and he takes the spy glass and puts it to his blind
19 eye and says, I see no signal, continues and wins the battle.

20 Why do I tell that anecdote. Because I like it, of
21 course.

22 THE COURT: Would you have told the story if he lost
23 the battle.

24 MR. SHEEHAN: The bottom line is, I tell that for this
25 reason. There is a purpose. Because it describes conduct.

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1 It's not a standard. It's conduct. I don't say there aren't
2 three. And if I said that or I spoke that way, let me correct
3 it. What I'm saying is this that willful blindness' conduct is
4 utilized, as Judge Sweet did, when he's talking about mere
5 suspicion. And others have used willful blindness when they
6 talk about conscious disregard.

7 But the cases are different in the sense, Judge Sweet
8 is in the ballpark of what, the UCC, very similar to the
9 standard utilized, inquiry notice, the bankruptcy code, et
10 cetera. Willful blindness conduct, conscious disregard, in the
11 cases cited by my adversary are in the aiding and abetting
12 where scienter, intent, those kinds of issues are part of the
13 pleading. They are part of the cause of action. The fact that
14 in both instances they turn a blind eye doesn't necessarily
15 mean that the standard of inquiry is the same and that's my
16 point and that's the only point I was trying to make.

17 One last point, only because it was not the media that
18 alerted them to front running and it wasn't the media that
19 talked about -- it was Peter Stamos, people from Stamos, and
20 let me pick up on this. Peter Stamos testified on the same
21 page just what my adversary said, that Mr. Madoff was a
22 sterling member of the industry. It's not quote. It's a
23 paraphrase. That's in essence what he said, no question. Same
24 page he said, he would not pass, would not pass our fiduciary
25 standards to be admitted to our hedge fund. Excuse me? Is

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1 that a fact issue, your Honor? Is that something that a fact
2 finder would want to have Mr. Stamos on the stand and talk
3 about those two issues? I'm telling you this complaint is
4 writhe with those issues.

5 On that basis, the motion should be denied. Thank
6 you, your Honor.

7 THE COURT: Thank you very much.

8 By the way, my recollection is that the main reason
9 Admirable Nelson was turning his blind eye to the battle was
10 because his good eye was centered on his mistress.

11 Let's talk about schedule because first I am convinced
12 that no matter how this case plays out, there are important
13 and, by no means, self-evident nonbankruptcy issues that need
14 to be resolved, and I really think it's appropriate, therefore,
15 for the district court to keep this particular case, which I
16 didn't feel in the situation involving HSBC, and I want to make
17 the record clear, as I thought on many occasions, that I think
18 Judge Lifland is one of the great, great bankruptcy judges of
19 this nation. So this is in no way a reflection on the
20 fantastic job that I'm sure he would do, but simply because
21 under the law I think it's appropriate that a district judge
22 take a matter into the district court when there are
23 significant and, by no means, obvious nonbankruptcy issues
24 involved.

25 So it will take me a while to get out a decision on

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1 this motion. Certainly I expect a decision, worst case, by the
2 end of September, but it may not be much sooner than that.

3 I think discovery should go forward. I think that if
4 it turns out that the defendant wins the motion across the
5 board, so a little discovery will have occurred in the interim,
6 but I don't think they will be seriously prejudiced in that
7 regard. Whereas if I don't grant motion across the board,
8 discovery will be all for the good because we can move forward
9 promptly.

10 I'm also sort of in between the two parties with
11 respect to the trustee's right to take discovery. I think that
12 the trustee should be allowed to take some additional
13 discovery, but I think it has to be cabined by the discovery
14 that's already taken place. And we will have to decide this on
15 a sort of item-by-item issue. I can't make an across-the-board
16 ruling.

17 Let me ask both counsel, assuming for the sake of
18 argument that the case goes forward in full and, again, no one
19 should infer anything, this is so we could have a schedule we
20 could all live by, how long would it take to complete discovery
21 in this case?

22 Let me ask the trustee first.

23 MR. SHEEHAN: I have not really given it a lot of
24 thought, but I'll give my best shot. I think by the end of the
25 year, beginning, something like that. We may need a minor

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1 extension at the end, but it will be on a very specific basis
2 if that happens.

3 THE COURT: How about defense counsel?

4 MS. WAGNER: Your Honor, I'm sure we can comply with
5 that, too. If I may just ask a couple of questions. I'm
6 assuming from what you just said we are not going to repeat
7 what we have done.

8 THE COURT: No.

9 MS. WAGNER: It's going to be whatever new things --

10 THE COURT: I'm already anticipating enumerable phone
11 calls I will get from you jointly to resolve just that kind of
12 issue.

13 MS. WAGNER: Another request, your Honor, if we are
14 going to be doing discovery, I'm assuming that you would also
15 request that the trustee would give us what he has already
16 taken.

17 THE COURT: I think that sounds reasonable. But,
18 again, I don't want to make any rulings. I just want to get a
19 time frame today, and then we can take up all the nuances of it
20 in further conversations.

21 You agree that discovery could be completed by the end
22 of the year?

23 MS. WAGNER: I do, your Honor.

24 THE COURT: Then we would have postdiscovery motion
25 practice, which in my court is always six weeks: Two weeks for

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1 moving papers, two weeks for answering papers, one week for
2 reply paper, one week for oral argument. And it would take me,
3 I don't think, more than two weeks to resolve that motion. So
4 that would take us to the beginning of March.

5 I would propose that we set this down for trial on
6 Monday, March 5.

7 Again, on a worst-case scenario, because that's all
8 I'm dealing with now, how long a trial do you think it would
9 be?

10 MR. SHEEHAN: I'd say ten days, your Honor.

11 MS. WAGNER: Your Honor, I'm sure that's more than
12 enough.

13 THE COURT: This is a jury trial, at least in part?

14 MR. SHEEHAN: I would say, yes, we want a jury.

15 THE COURT: I'll put aside two weeks so the jury will
16 have time to deliberate. This is without prejudice to anyone
17 arguing that some or all of the issues might not be jury
18 issues. For example, I don't think the subrogation issue is a
19 jury issue, but maybe not.

20 So, again, that's the trial date. We now have the
21 schedule. But no one should infer anything about how I'm
22 coming out of this motion, and I may grant the motion in its
23 entirety, in which case this will all be moot. I wanted to
24 thank all counsel for their very excellent arguments, much
25 appreciated, and this matter is adjourned. (Adjourned)

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