"It Ain't Over Till It's Over": United States District Court for the Southern District of New York Denies Madoff Trustee's Bid for an Interlocutory Appeal

February 2, 2012 by Diana Perez and Michael A. Stevens

Quoting the great sage Yogi Berra, on January 17, 2012, Judge Jed S. Rakoff of the United States District Court for the Southern District of New York denied the motion of Irving H. Picard, the SIPA trustee for Bernard L. Madoff Investment Securities LLC, for the immediate appeal of the District Court's order dismissing or otherwise narrowing certain of the trustee's claims against the defendants, who are former customers of Madoff Securities. Picard v. Katz, 11 Civ. 3605 (JSR), 2012 U.S. Dist. LEXIS 5143 (S.D.N.Y. Jan. 17, 2012). The District Court's decision reinforces the principle that appeals are best taken once a final judgment is entered, as interlocutory appeals generally cause "vexatious and duplicative litigation, prolonged uncertainty, and endless delay."

As discussed in an earlier post, on September 27, 2011, the District Court dismissed all but three counts of an adversary proceeding commenced by the trustee against a group of defendants headlined by the current owners of the New York Mets. In the instant motion, the trustee requested that the District Court certify three of its rulings for an interlocutory appeal pursuant to 28 U.S.C. § 1292(b), or enter a final and appealable judgment pursuant to Federal Rule of Civil Procedure 54(b) on the claims dismissed by the District Court's ruling that section 546(e) of the Bankruptcy Code barred the trustee's preference and constructive fraudulent transfer claims because the payments Madoff Securities made to the defendants each qualified as either a settlement payment or a transfer made in connection with a securities contract.

After noting the strong bias against granting interlocutory appeals, the District Court rejected the trustee's motion in its entirety, finding that the case lacked the requisite "exceptional circumstances" that would justify granting an interlocutory appeal under either Rule 54(b) or section 1292(b) of the Judicial Code. The District Court found that to proceed with an interlocutory appeal would materially delay the resolution of the pending adversary proceeding, which is set for trial in March 2012. Moreover, the District Court determined that the factual record to be developed at the upcoming trial will be relevant to the very issues the trustee sought to raise on interlocutory appeal, and will expedite the adjudication of the trustee's other adversary proceedings that share similar issues.

The District Court also rejected the trustee's argument, which was not raised at the time of the underlying decision, that a brokerage customer is per se not entitled to the protections of section 546(e) if the purported stockbroker is actually conducting a Ponzi scheme. The District Court found that none of the cases the trustee cited were relevant to the issue of whether a licensed stockbroker engaged in a Ponzi scheme should not be considered a stockbroker for purposes of section 546(e). The District Court distinguished two of the cases relied on by the trustee: Adler, Coleman Clearing Corp., 263 B.R. 406 (S.D.N.Y. 2001) and Picard v. Merkin, No. 6808-VCG, 2011 WL 3897070 (S.D.N.Y. 2011). In contrast to Adler, where Judge Marrero implied a fraud exception to section 546(e) to prevent the absurd result by which the defendant would benefit from its own fraud, Judge

Rakoff found that the effect of section 546(e) in the instant case is to preserve the safe harbor only for those transfers that the trustee could not avoid under section 548(a)(1)(A), the Bankruptcy Code's "actual" fraudulent transfer provision. With respect to Merkin, the District Court found that Judge Wood's decision actually supported the denial of the trustee's motion for an interlocutory appeal. In Merkin, Judge Wood denied a request for an interlocutory appeal by the receiver of certain Madoff Securities defendants because the receiver had failed to establish that there was a substantial difference of opinion over whether, for purposes of section 546(e), Madoff Securities qualified as a "stockbroker" that had "securities contracts" with its customers.

Judge Rakoff's decision is not particularly unique in echoing the federal judiciary's longstanding aversion to interlocutory appeals. Its focus on the applicability of section 546(e) in this context, however, is particularly relevant at the present time, when bankruptcy trustees and other estate fiduciaries, including those in Ponzi scheme cases, are increasingly attempting to avoid certain securities transactions.