



Can Madoff Trustee Go After the Banks?

Posted by John F. Savarese, Wachtell, Lipton, Rosen & Katz, on Friday December 2, 2011

Editor's Note: [John Savarese](#) is a partner in the Litigation Department of Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton firm memorandum by Mr. Savarese, [Douglas K. Mayer](#), [Stephen R. DiPrima](#), and [Emil A. Kleinhaus](#).

Recently, the United States District Court for the Southern District of New York ruled that the trustee for Bernard L. Madoff Investment Securities lacks authority to pursue common-law damages claims belonging to the investors in Madoff's Ponzi scheme. Based on that ruling, the court dismissed claims against JPMorgan and UBS seeking to hold the banks liable for customer losses resulting from Madoff's scheme. [Picard v. JPMorgan Chase & Co., No. 11 civ. 913 \(S.D.N.Y. Nov. 1, 2011\) \(McMahon, J\)](#).

It is a longstanding principle of bankruptcy law that a trustee, as successor to the debtor, may not bring claims that belong to creditors. It is also well-established that, where the debtor has defrauded its creditors, the trustee — who stands in the debtor's shoes — cannot recover from third parties for wrongdoing that the debtor itself took part in.

In attempting to escape these principles, the Madoff trustee argued that the Securities Investor Protection Act (SIPA), which governs the liquidation of broker dealers, provides a SIPA trustee with broader powers than an ordinary bankruptcy trustee, including the power to bring claims belonging to creditors (in this case, Madoff's former customers). The Madoff trustee purported to have such standing as a "bailee" of customer property. The trustee also argued that section 544(a) of the Bankruptcy Code, which grants a trustee rights of a hypothetical creditor that extends credit to the debtor at the time of its bankruptcy, permits a trustee to assert damages claims that belong to actual creditors.

The district court squarely rejected these arguments, concluding that a SIPA trustee has no standing to assert common law claims belonging to creditors. Consistent with a recent decision by District Judge Rakoff, *Picard v. HSBC Bank PLC*, 450 B.R. 406 (S.D.N.Y. 2011), the court held that a SIPA trustee does not have broader standing than other bankruptcy trustees. The court explained that no "bailment" existed between Madoff and his customers, because "a thief can

never take the status of a bailee,” and that nothing in SIPA creates an independent bailment in favor of the trustee. The court also concluded that, while section 544(a) of the Bankruptcy Code permits a trustee to cut off secret or unperfected liens on a debtor’s property, it does not authorize a trustee to bring causes of action belonging to creditors.

The *JPMorgan* and *HSBC* decisions reaffirm that a trustee for a bankrupt debtor — whether in a SIPA proceeding or a regular bankruptcy case — has limited powers and does not have a broad commission to assert claims belonging to the debtor’s stakeholders.