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Appellate Court: Madoff Trustee Lacks Authority to Go After Banks

Posted by John F. Savarese, Wachtell, Lipton, Rosen & Katz, on Thursday June 27, 2013

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, Stephen R. DiPrima, Emil A. Kleinhaus, and Jonathon R. La Chapelle.

The U.S. Court of Appeals for the Second Circuit held today that the trustee for Bernard L. Madoff Investment Securities (BLMIS) lacks authority to pursue common-law claims for damages suffered by Madoff's customers. Based on that ruling, the Court affirmed the dismissal of a variety of damages claims against JPMorgan, HSBC and other banks relating to Madoff's historic Ponzi scheme. *See* Picard v. JPMorgan Chase & Co., No. 11-5044 (2d Cir. June 20, 2013). Our firm represented JPMorgan both in the district court and on appeal.

Since the Supreme Court's landmark decision in *Caplin* v. *Marine Midland*, 406 U.S. 416 (1972), it has been well-established that a bankruptcy trustee — as the legal successor to the debtor — may not bring damages claims that belong to creditors. It is also well-established that, under the doctrine of *in pari delicto*, the bankruptcy trustee for a fraudulent debtor may not sue third parties for harms caused by the debtor's own fraud.

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 expanded powers, including the power to bring claims as a "bailee" of customer property held by the broker. In two separate decisions, the district courts squarely rejected the trustee's position, holding instead that a SIPA trustee does not have broader powers than an ordinary bankruptcy trustee.

On appeal, the Second Circuit affirmed the dismissal of the trustee's damages claims. The Court held that the trustee "stands in the shoes of BLMIS" and thus may not assert claims against third parties for allegedly "participating in a fraud that BLMIS orchestrated." The Court also held that, under *Caplin*, the trustee cannot step out of the debtor's shoes and usurp the individual claims of defrauded customers. Finding the trustee's arguments "inapt and unconvincing," the Court

rejected the notion that the trustee could sue as a “bailee” of customer property. The Court explained that SIPA does not speak in terms of “bailment” and that, under New York law, “a thief” such as BLMIS “is not a bailee of stolen property.” The Court likewise rejected the notion that the Securities Investor Protection Corporation (SIPC), an agency created by SIPA to reimburse customers for losses, could sue as a “subrogee” of customers it had reimbursed, again finding no source in the statute for such broad authority.

The Second Circuit’s decision strongly reaffirms that a trustee for a bankrupt debtor — including a brokerage firm liquidating under SIPA — has limited statutory authority and does not have a commission to spearhead mass actions that aggregate and assert claims belonging to creditors.