UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES INVESTOR PROTECTION CORPORATION, Plaintiff-Applicant, v. BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Defendant.	Adv. Pro. No. 08-01789 (BRL) SIPA LIQUIDATION (Substantively Consolidated)
In re: BERNARD L. MADOFF, Debtor.	
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. EQUITY TRADING PORTFOLIO LIMITED *et al.*, Defendants.	Adv. Pro. No. 10-04457 (BRL) No. 11-cv-07810 (JSR)
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. OREADES SICAV REPRESNTED BY ITS LIQUIDATOR INTER INVESTISSEMENTS S.A., *et al.*, Defendants.	Adv. Pro. No. 10-5120 (BRL) No. 11-cv-07763 (JSR)

MEMORANDUM OF LAW OF THE
SECURITIES INVESTOR PROTECTION CORPORATION
IN OPPOSITION TO DEFENDANTS'
MOTIONS TO WITHDRAW THE REFERENCE

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PUBLICATIONS AND TREATISES:

The Securities Investor Protection Corporation ("SIPC") submits this memorandum of law in opposition to the motions ("Motions") of BNP Paribas Investment Partners Luxembourg S.A. ("BNP Investment"), BGL BNP Paribas S.A. ("BGL BNP"), BNP Paribas Securities Services S.A. ("BNP Securities," and together with BNP Investment and BGL BNP, "BNP Oreades") and BNP Paribas Arbitrage, SNC ("BNP Arbitrage," and together with BNP Oreades, "Movants"), to withdraw the reference of these adversary proceedings from the United States Bankruptcy Court for this District ("Bankruptcy Court").[1] In these proceedings, the trustee ("Trustee") for the substantively consolidated liquidation proceedings of Bernard L. Madoff Investment Securities LLC ("BLMIS" or "Debtor") under the Securities Investor Protection Act, 15 U.S.C. § 78aaa *et seq.* ("SIPA"), and of Bernard L. Madoff ("Madoff"), seeks to recover from Movants BLMIS customer funds transferred to them by funds invested with BLMIS which are named as Defendants, but which are not moving to withdraw the reference here.[2] The actions are brought, in part under avoidance provisions of Title 11 of the United States Code ("Bankruptcy Code"), made applicable under SIPA section 78fff(b), and state law relating to fraudulent conveyances, made applicable under the Bankruptcy Code. Movants urge the Court to withdraw the reference of the proceedings on the purported grounds that 1) section 546(e) of the Bankruptcy Code provides a safe harbor protecting the transfers at issue; 2) the Trustee's claims require extraterritorial application of SIPA and the Bankruptcy Code; 3) the Supreme Court's

[1] On February 17, 2012, Inter Investissements S.A., another subsequent transferee defendant, separately filed a joinder to the Motion of BNP Oreades. To the extent the joinder is deemed to have been properly filed, the SIPC respectfully requests that the Court consider this response to be in opposition to the joinder as well.

[2] For convenience, references herein to provisions of SIPA shall omit "15 U.S.C."

Under SIPA §78eee(d), SIPC is "a party in interest as to all matters arising in a liquidation proceeding, with the right to be heard on all such matters…."

decision in *Stern v. Marshall*, ___U.S.___, 131 S.Ct. 2594 (2011), requires that this case be heard in this Court; and 4) the Securities Litigation Uniform Standards Act of 1998 ("SLUSA")[3] protects recipients of Ponzi scheme proceeds from recovery under the Bankruptcy Code and related common law causes of action.

STATEMENT OF THE ISSUE

The Motions present the following issue:

> Whether under 28 U.S.C. section 157(d), withdrawal of the reference of an adversary proceeding arising in a liquidation proceeding under SIPA is warranted and/or appropriate where:
>
> 1) SIPA mandates the removal of the liquidation proceeding to the bankruptcy court;
>
> 2) to the extent consistent with SIPA, the liquidation proceeding generally is to be conducted "in accordance with" and "as though it were being conducted under" Title 11;
>
> 3) the adversary proceeding presents only "core" claims that arise directly under Title 11, and as such, withdrawal of the reference of the proceeding would interfere with the Bankruptcy Court's consideration of matters that Congress has deemed to be within the basic competence of that court; and
>
> 4) SIPA and Title 11, *inter alia*, mandate exclusive jurisdiction in the Bankruptcy Court over "customer property of the debtor" wherever located and by whomever held, reflecting a Congressional intent to extend jurisdiction extraterritorially.

SIPC respectfully submits that under the facts presented, withdrawal of the reference to the Bankruptcy Court is neither warranted nor appropriate.

STATEMENT OF FACTS

These are adversary proceedings to recapture BLMIS customer funds that were stolen by BLMIS and subsequently transferred to Movants.

[3] 15 U.S.C. §§ 77p(b)(1) and 78bb(f).

As alleged in the Complaint in Case No. 11-cv-7763 ("Oreades Complaint"), BNP Oreades served as managers and custodians to Oreades SICAV ("Oreades"), a fund with an account at BLMIS. *See* Oreades Complaint at ¶42. Since December 2002, Oreades received over $430 million from BLMIS, $160 million of which was fictitious profits from the Ponzi scheme. *Id.* at ¶2.

The Trustee contends that BNP Oreades should have been aware of numerous red flags that BLMIS was a Ponzi scheme. For example, BNP Investment representatives corresponded with BLMIS on two separate occasions regarding Oreades's account, including questioning why they had not received a cash statement and whether that was "normal." *Id.* at ¶48. Representatives of BNP Securities also had significant concerns about BLMIS. For example, a BNP Securities representative realized that BLMIS was not properly registered with the Luxembourg authorities, asked for the identity of BLMIS's clearing broker, and asked why BLMIS sent confirmations by mail a week after settlement, which was not industry standard. *Id.* at ¶¶54-56. These concerns were dropped once BLMIS's three-man auditor, Friehling & Horowitz, confirmed Oreades's securities positions. *Id.* at ¶59.

As alleged in the Complaint in Case No. 11-cv-07810 ("Equity Trading Complaint"), BNP Arbitrage received a preference payment of $15 million transfer from Equity Trading Portfolio Limited about one month before the filing of the BLMIS liquidation proceeding. *See* Equity Trading Complaint at ¶100.

In these adversary proceedings, the Trustee seeks to recover the subsequent transfers of the property to Movants. All of the causes of action asserted by the Trustee are "core" matters arising under the Bankruptcy Code or related state law. The Trustee seeks to avoid the initial transfers against the non-moving Defendants as (i) preferential transfers under Bankruptcy Code

sections 547(b), 550(a) and 551; (ii) actual fraudulent transfers under Bankruptcy Code sections 544, 548(a)(1)(A), and 551, and New York Debtor and Creditor Law ("NYDCL"); and (iii) constructive fraudulent transfers under Bankruptcy Code sections 544, 548(a)(1)(B), and 551, and the NYDCL. The Trustee seeks to recover the transfers from Movants, as subsequent transferees, under the aforementioned preference and fraudulent transfer provisions of the Bankruptcy Code, under provisions of the NYDCL, and under the doctrines of unjust enrichment, money had and received, and conversion.

SUMMARY OF ARGUMENT

The instant Motions are unwarranted attempts to remove to this Court matters within the Bankruptcy Court's "core" jurisdiction and competence. Through the Complaints, the Trustee asserts claims under the Bankruptcy Code and the NYDCL that do not require substantial interpretation of SIPA or any other federal statute. All of the Trustee's claims constitute "core" matters within the meaning of 28 U.S.C. §§ 157(b)(2)(A), (E), (F), (H), and (O).

Notwithstanding the Bankruptcy Court's clear authority, Movants attempt to recast these traditional bankruptcy actions as "novel" issues of law, citing asserted inconsistencies between Title 11 and SIPA, and arguing that the actions are improper under SLUSA. Movants ignore the fact that they are subsequent transferees and that the Trustee's suits against them are based, in part, on section 550(a) of the Bankruptcy Code. Instead, they argue that they are entitled to retain the transfers because section 546(e) of the Bankruptcy Code provides a safe harbor, even if Movants were willfully blind, as alleged by the Trustee, to the receipt of stolen customer funds. Movants also contend that application of the recovery provisions to the transfers received would be improper as an extraterritorial application of SIPA and the Bankruptcy Code, and that the Supreme Court's decision in *Stern v. Marshall* precludes the exercise of jurisdiction by the

Bankruptcy Court.

All of these arguments fail. Contrary to Movants' assertions, the exercise of jurisdiction by the Bankruptcy Court is consistent with both the Bankruptcy Code and *Stern*, and SIPA does not change that result. The safe harbor provision invoked by Movants does not apply to these proceedings. Moreover, both SIPA and the Bankruptcy Code expressly provide for jurisdiction over both "customer property" and property of the estate, wherever located, precisely the property that the Trustee seeks to recover through these suits. Finally, SLUSA does not prohibit the Trustee from bringing these actions.

ARGUMENT

I. THE STANDARDS FOR WITHDRAWAL ARE NOT MET

A. Standards Governing Mandatory Withdrawal

28 U.S.C. section 157(d) governs withdrawal of the reference to the bankruptcy court, and provides for both mandatory and discretionary withdrawal. A district court must withdraw a reference where "[t]he court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce." *Id.* The purpose of this provision is to reserve to the federal district courts those issues that Congress "intended to have decided by a district judge rather than a bankruptcy judge." *In re Johns-Manville Corp.*, 63 B.R. 600, 602 (S.D.N.Y. 1986).

Because the language of section 157(d)'s mandatory withdrawal provision, if read literally, would eliminate much of the work of the bankruptcy courts, the district courts are cautioned to construe this sentence "narrowly." *In re Adelphi Institute, Inc.*, 112 B.R. 534, 536 (S.D.N.Y. 1990) ("*Adelphi*"). In fact, section 157(d) does not mandate withdrawal unless the district court makes an affirmative determination that resolution of the matter in question will

require "substantial and material consideration" of non-Title 11 federal statutes. *See In re Ionosphere Clubs, Inc.*, 922 F.2d 984, 995 (2d Cir. 1990), *cert. den. sub nom., Air Line Pilots Ass'n Intern. AFL-CIO v. Shugrue*, 502 U.S. 808 (1991); *Adelphi*, 112 B.R. at 536. This standard is stringent, and is designed to ensure that the mandatory withdrawal provisions of section 157(d) do not become "an escape hatch for matters properly before [the bankruptcy] court." *Adelphi*, 112 B.R. at 536 (*quoting In re Johns-Manville Corp.*, 63 B.R. at 603).

B. Standards Governing Permissive Withdrawal

Section 157(d) also permits a district court to withdraw the reference, *inter alia*, "[o]n timely motion of any party, for cause shown." Courts in this jurisdiction consider a number of factors in determining whether "cause" for a discretionary withdrawal of the reference exists. The Second Circuit, however, has emphasized that the threshold question is whether a claim is core or non-core. *See In re Orion Pictures Corp.*, 4 F.3d 1095, 1100-02 (2d Cir. 1993), *cert. dismissed*, 511 U. S. 1026 (1994) ("*Orion Pictures Corp.*"). In fact, determination of this question has a profound impact on the relevance of many of the factors often considered in connection with a motion for discretionary withdrawal, including, for example, whether judicial efficiency is best served by withdrawal of the reference. *See, e.g., Orion Pictures Corp.*, 4 F.3d at 1101 (explaining that "questions of efficiency and uniformity will turn" on whether a claim is core or non-core).

Neither mandatory nor permissive withdrawal is warranted here.

II. RECOVERY ACTIONS IN A SIPA PROCEEDING ARE TO BE CONDUCTED AS RECOVERY ACTIONS UNDER TITLE 11

The matters herein typically are considered by bankruptcy courts. That this adversary proceeding arises in the context of a SIPA liquidation does not alter that fact. As discussed below, at least four sections of SIPA make that clear.

A. Section 78eee(b)(4) and Removal to the Bankruptcy Court

Section 78eee(b)(4) is headed "Removal to Bankruptcy Court" and specifies that upon the issuance of the customer protective decree and appointment of a trustee, the district court "shall forthwith order the removal of the entire liquidation proceeding to the court of the United States in the same judicial district having jurisdiction over cases under title 11." The relevant case law under, and history of, SIPA illustrate that Congress intended SIPA proceedings to be considered by the bankruptcy courts.

Although the original version of SIPA did not expressly include a removal or referral provision, the Second Circuit concluded in *Exchange National Bank of Chicago v. Wyatt*, 517 F.2d 453 (2d Cir. 1975) ("*Wyatt*"), that referral of the proceedings to the bankruptcy courts carried out the purposes of SIPA. In doing so, the court examined: 1) section 5(b)(2) of SIPA, 15 U.S.C. § 78eee(b)(2) (1970), giving to the district courts exclusive jurisdiction over the debtor and its property and the powers of a bankruptcy court and of a court in a proceeding under chapter X of the Bankruptcy Act;[4] 2) section 6(c)(1), 15 U.S.C. § 78fff(c)(1) (1970), providing that the SIPA proceeding would be conducted "in accordance with, and as though it were being conducted under," specified provisions of the Bankruptcy Act; and 3) section 6(c)(2), 15 U.S.C. § 78fff(c)(2) (1970), setting forth provisions that were unique to a SIPA liquidation. The Second Circuit observed that since section 22 of the Bankruptcy Act, providing for a general reference of

[4] In 1970, while specifying that a debtor under SIPA would not be reorganized, SIPA incorporated provisions of the Bankruptcy Act applicable to reorganization proceedings. *See* S. Rep. No. 91-1218, at 13 (1970), and *Redington v. Touche Ross & Co.*, 612 F.2d 68, 71-72 (2d Cir. 1979). In 1978, Congress deleted the reference to the reorganization provisions and expressly made the liquidation provisions applicable. Pub. L. No. 95-283, 92 Stat. 249, 259 (1978), and Pub. L. No. 95-598, 92 Stat. 2549, 2675 (1978). *See Hearings on H.R. 8331 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce*, 95th Cong., 175-76 (1977).

cases to referees in bankruptcy, was contained in a chapter of the Bankruptcy Act that applied to a SIPA proceeding, reference of the SIPA proceeding would be proper. 517 F.2d at 456. The power of the district court to refer SIPA proceedings to referees in bankruptcy was not only "consistent with the purposes of SIPA but essential."[5] *Id.* at 457.

Congress's intent that SIPA matters be heard by bankruptcy courts was made clear twice in 1978, first when it amended SIPA to include section 78eee(b)(4), and second when, several months later, it revised that section to its current form. The provision initially authorized the district court "at any stage of the [SIPA] proceeding, [to] refer the proceeding to a referee in bankruptcy to hear and determine any or all matters, or to a referee in bankruptcy as special master to hear and report generally or upon specified matters." Pub. L. No. 95-283, 92 Stat. 249, 257 (1978). In adding the section, Congress explained that "[a]uthority for the existing practice of referring all or part of a liquidation proceeding to a referee in bankruptcy, thereby in many cases expediting liquidation proceedings, is clarified. *See, e.g.*, [*Wyatt*]." S. Rep. No. 95-763, at 10 (1978). *See also* H.R. Rep. No. 95-746, at 27 (1977).

Subsequently, section 308 of Title III of the Bankruptcy Reform Act of 1978 made certain amendments to SIPA to conform it to the Bankruptcy Code. *See* S. Rep. No. 95-989, at 19

[5] That the bankruptcy court is best-equipped to handle the liquidation of financially failing securities broker-dealers finds support in *SEC v. American Bd. of Trade, Inc.*, 830 F.2d 431, 436-438 (2d Cir. 1987), *cert. den. sub nom., Economou v. SEC*, 485 U.S. 938 (1988). *See also* Anthony Michael Sabino, *The Role of Bankruptcy Courts in Stockbrokerage Liquidations*, 16 Sec. Reg. L. J. 227 (Fall 1988). In *American Board of Trade*, the Second Circuit expressed misgivings over the use of a district court equity receivership to effect the liquidation of insolvent entities, stating that the district court had undertaken to oversee routine bankruptcy matters, "without the aid of either the experience of a bankruptcy judge or the guidance of the bankruptcy code." 830 F.2d at 438. The Second Circuit admonished that in the future, such receiverships were not to be continued "beyond the point necessary to get the estate into the proper forum for liquidation – the bankruptcy court." *Id.* at 437.

(1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5805. Section 78eee(b)(4) was amended to its present form, providing for removal to the "court of the United States in the same judicial district having jurisdiction over cases under title 11." Pub. L. No. 95-598, 92 Stat. 2549, 2674 (1978). The intended court was the bankruptcy courts because under 28 U.S.C. § 1471(c), Pub. L. No. 95-598, 92 Stat. 2549, 2668 (1978), the bankruptcy courts would exercise all of the jurisdiction of the district courts including jurisdiction over Title 11 cases.[6]

Although SIPA was thereby brought in line with the broader jurisdiction and powers which the 1978 Bankruptcy Reform Act conferred upon bankruptcy courts, Congress already independently had demonstrated its intent that SIPA liquidation proceedings be considered by the bankruptcy courts. Thus, in section 78eee(b)(4), as originally enacted, Congress expressly provided for referral of all or part of the proceedings to bankruptcy referees to make clear its intent, because such referrals would "expedite" the liquidations. When considered with SIPA section 78fff(b) making Title 11 provisions applicable to a SIPA proceeding, the intent of current section 78eee(b)(4) is plain that except for the special protection afforded customers,[7] SIPA liquidation proceedings are to be administered no differently than ordinary Title 11 bankruptcies.

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[6] Ultimately, section 1471(c) did not become effective pursuant to section 402(b) of Pub. L. No. 95-598, as amended. It is noteworthy that the broader powers conferred upon the bankruptcy courts nevertheless remained unchanged in SIPA section 78eee(b)(4). Whether the jurisdiction and powers of a bankruptcy court in a SIPA case are broader than in ordinary bankruptcy is not at issue, as the bankruptcy court under the facts of the case at hand would exercise no broader jurisdiction and powers than it would in ordinary bankruptcy.

[7] In a SIPA proceeding, "customers" share on a priority basis and *pro rata* in "customer property," that is, property received, acquired or held for them by the broker. To the extent such property is insufficient to satisfy a customer claim, the customer is eligible to have his claim satisfied through an advance of funds by SIPC – up to $500,000 of which up to $100,000 (raised to $250,000 in 2010) may be used to satisfy the portion of a claim that is for cash only. If the customer's claim is still unsatisfied, the customer shares in any general estate, *pro rata*, with unsecured general creditors. *See* SIPA §§78*lll*(2) and (4); 78fff-2(c)(1); and 78fff-3(a).

B. Section 78fff(b) Supplies An Additional Basis for the Exercise of Jurisdiction

Under 28 U.S.C. section 157(b)(1), the bankruptcy court exercises the district court's jurisdiction with respect to all cases under Title 11 and all "core" proceedings arising under Title 11, or arising in a case under Title 11, referred by the district courts. In the context of 28 U.S.C. § 157(b)(1), SIPA section 78fff(b) supplies an additional basis for the exercise of jurisdiction by the bankruptcy courts.

There are two operative requirements in the first sentence of section 78fff(b). To the extent consistent with SIPA, the SIPA liquidation proceeding is to be conducted 1) "in accordance with" and 2) "as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of title 11." The provisions of Title 11 referred to in section 78fff(b) are the bankruptcy liquidation provisions of the Code, except for the stockbroker and commodity broker provisions. In order for the SIPA liquidation to be conducted "in accordance with" Title 11, the bankruptcy provisions, including those sections relied upon in these proceedings, must be held to apply in a SIPA case. *Cf., National Union Fire Insurance Co. of Pittsburgh, Pa. v. Camp (In re Government Securities Corp.)*, 972 F.2d 328, 330-331 (11th Cir. 1992), *cert. den.*, 507 U.S. 952 (1993).

Furthermore, because the SIPA liquidation must be conducted "as though it were being conducted" under the straight bankruptcy provisions of Title 11, the procedures that apply to Title 11 actions also must be deemed to apply to actions in SIPA liquidations.

In the context of an ordinary bankruptcy case, this adversary proceeding raises "core" matters under 28 U.S.C. sections 157(b)(2)(A), (E), (F), (H), and (O), which automatically would be referred to the Bankruptcy Court under the Amended Standing Order of Reference issued by this Court on February 1, 2012, and would be heard and considered by the Bankruptcy Court

under 28 U.S.C. § 157(b)(1). If the second requirement of section 78fff(b) is to be implemented, there can be no different outcome here merely because the adversary proceeding is brought within a SIPA liquidation. The fact that a SIPA liquidation is simply an outright bankruptcy proceeding for all practical purposes has been consistently recognized. *See* SIPA § 78fff(a). *See also Wyatt*, 517 F.2d at 457-459; *In re Lloyd Secs., Inc*., 75 F.3d 853, 857 (3d Cir. 1996); *SIPC v. Ambassador Church Finance/Development Group, Inc.*, 788 F.2d 1208, 1210 (6th Cir.), *cert. den. sub nom., Pine Street Baptist Church v. SIPC*, 479 U.S. 850 (1986); *SEC v. Albert & Maguire Sec. Co.*, 378 F. Supp. 906, 909, 911 (E.D. Pa. 1974) (SIPA's predecessor was section 60e of the Bankruptcy Act). An adversary proceeding involving "core" matters brought in the context of a SIPA liquidation therefore should be adjudicated no differently than the same proceeding in a bankruptcy case. *See, e.g., Turner v. Davis Gillenwater & Lynch (In re Investment Bankers Inc.)*, 4 F.3d 1556, 1558, 1563 (10th Cir. 1993), *cert. den.*, 510 U.S. 1114 (1994) (holding that the bankruptcy court had jurisdiction to determine avoidance actions under Bankruptcy Code sections 547 and 548 in a SIPA liquidation); *In re Blinder, Robinson & Co*., 135 B.R. 899, 901 (D. Colo. 1992); *Jackson v. Mishkin (In re Adler, Coleman Clearing Corp.)*, 263 B.R. 406, 479, 496 (S.D.N.Y. 2001) (affirming bankruptcy court's judgment that fraudulent transfers to customers were avoidable in a SIPA liquidation).

C. **SIPA Vests The Trustee With The Same Powers And Title As A Title 11 Trustee**

SIPA section 78fff-1(a) specifies that the SIPA Trustee is "vested with the same powers and title with respect to the debtor and the property of the debtor… as a trustee in a case under title 11." The section includes one illustrative example of those powers, namely, "including the same rights to avoid preferences."

SIPA contemplates the satisfaction of certain customer claims, the liquidation of the

debtor's business, and the satisfaction of claims filed by general creditors. *See* §§ 78fff(a)(4), 78fff-2(a)(3). To accomplish those ends, the SIPA trustee has the same powers as a chapter 7 bankruptcy trustee, and additional powers that enable him to perform the special functions of a SIPA liquidation. *See* SIPA § 78fff-1(a). *See also Executive Securities Corp. v. Doe*, 702 F.2d 406, 407 (2d Cir.), *cert. den*., 464 U.S. 818 (1983); *SIPC v. Christian-Paine & Co.*, 755 F.2d 359, 361 (3d Cir. 1985); *SEC v. Albert & Maguire Sec. Co*., 560 F.2d 569, 574 (3d Cir. 1977); *Gold v. Hyman*, [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,043 at 97,657-58 (S.D.N.Y. 1975).

Because the Trustee's responsibilities extend not only to stockbroker customers but to the entire bankruptcy estate, *In the Matter of Lewellyn*, 26 B.R. 246, 253-254 (Bankr. S.D. Iowa 1982), the Trustee may sue to recover assets to satisfy, among others, unpaid customers. *See Gold v. Hyman, supra*, at 97,657; *Bondy v. Chemical Bank*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,360 at 98,784, 98,785-86 (S.D.N.Y. 1975). Toward that end, among other things, since enactment, SIPA has conferred upon the SIPA trustee the powers of a bankruptcy trustee to avoid and recover transfers. As stated in 3 *Collier on Bankruptcy* ¶60.85 at 1246 (14th ed. 1977):

> The trustee, therefore, has all the powers conferred by the Bankruptcy Act upon an ordinary bankruptcy trustee to avoid or set aside transfers of property or other transactions occurring prior to institution of the proceedings, to recover property and collect the assets of the estate or to assert any right or defenses the debtor might have against the claims of others …. In short, whenever an ordinary bankruptcy trustee could under the Bankruptcy Act invalidate a transaction or transfer, the SIPA trustee can do the same, and the fact that he was appointed under SIPA does not suggest a different rule.

See 1 *Collier on Bankruptcy* ¶12.14[3] at 12-70 (16th ed. 2011). *See also Mishkin v. Ensminger (In re Adler Coleman Clearing Corp.*), 218 B.R. 689, 702 (Bankr. S.D.N.Y.1998) (holding that a SIPA trustee may bring fraudulent transfer claims under the Bankruptcy Code); *Klein v.*

Tabatchnick, 418 F.Supp. 1368 (S.D.N.Y. 1976), *aff'd in part and rev'd in part*, 610 F.2d 1043 (2d Cir. 1979) (unresolved factual questions making summary judgment improper); *Bondy v. Chemical Bank, supra*, at 98,786; *SEC v. North American Planning Corp.*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,326 at 98,640 (S.D.N.Y. 1975) ("[SIPA] Trustee alone has the power to recover property which has been fraudulently, preferentially or otherwise voidably transferred."); *SIPC v. S. J. Salmon*, 1973 U.S. Dist. LEXIS 15606, at *31 (S.D.N.Y. Aug. 8, 1973) ("But SIPA was not intended to make the fraudulent transfer provisions of the Bankruptcy Act inoperative as to stockbroker-debtors in SIPA proceedings.")

D. Section 78fff-2(c)(3) Permits the Trustee to Avoid and Recover Transfers of Customer Property

Finally, section 78fff-2(c)(3) expressly permits the Trustee to avoid and recover transfers of customer property to a customer where (i) "customer property is not sufficient to pay in full" all customer claims as set forth in SIPA section 78fff-2(c)(1)(A)-(D), and (ii) to the extent that the transfers are "voidable or void under the provisions of title 11." The section mandates that recovered property shall be treated as customer property as set forth in SIPA section 78*lll*(4). For purposes of determining whether a transfer is void or voidable under Title 11, the section treats the cash or securities so transferred as if they were owned by the debtor prior to transfer, and, if the transfer was for the benefit of a customer, treats the customer as if he was a creditor. These legal fictions permit the Trustee to fit the transfers into the provisions of the avoidance and recovery sections of Title 11. *See Hill v. Spencer Sav. & Loan Ass'n (In re Bevill, Bresler & Schulman, Inc.*), 83 B.R. 880, 893 (D.N.J. 1988) ("To promote equality of distribution to similarly situated claimants, the trustee is permitted, under 15 U.S.C. sec. 78fff-2(c)(3), to recover securities that would have been part of the fund of customer property but for a prior transfer to a customer.")

The concept of "customer property" in SIPA section 78*lll*(4) is expansive and is designed to ensure that customer property is funded for priority distribution to customers. *See Ferris, Baker Watts, Inc. v. Stephenson* (*In re MJK Clearing, Inc*.,), 286 B.R. 109, 132-133 (Bankr. D. Minn. 2002), *aff'd*, 2003 WL 1824937 (D. Minn. Apr. 07, 2003), *aff'd*, 371 F.3d 397 (8th Cir. 2004); *Horwitz v. Sheldon* (*In re Donald Sheldon & Co*.), 148 B.R. 385, 388-390 (Bankr. S.D.N.Y. 1992).

Taken together, the SIPA provisions discussed above make clear that a SIPA trustee has, at a minimum, all of the avoidance and recovery powers of an ordinary bankruptcy trustee to seek to avoid and recover transfers. That authority is clear in this case. Customer assets received by BLMIS that were converted by Madoff are "customer property." *See* SIPA section 78*lll*(4) ("customer property" includes "property unlawfully converted"). Madoff operated a Ponzi scheme in which the deposits of funds by later investors were used to fulfill earlier investors' requests for withdrawals of non-existent profits. *SIPC v. BLMIS (In re Bernard L. Madoff Investment Securities LLC)*, 424 B.R. 122, 125 (Bankr. S.D.N.Y. 2010), *aff'd*, 654 F.3d 229 (2d Cir. 2011). Thus, the monies transferred to Movants and sought by the Trustee in this action are assets that necessarily belong to customers and therefore qualify as customer property that the Trustee is entitled to recover. As discussed above, customer property is explicitly property of the estate for avoidance and recovery purposes, even though it takes on a special characterization under SIPA and is subject to the priority distribution plan provided in that statute.

III. MOVANTS RAISE NO ISSUE OF LAW OUTSIDE OF TITLE 11

Movants contend that SIPC argues for an expansion of the Trustee's powers beyond the Bankruptcy Code. On the contrary, SIPC supports the Trustee's position that a SIPA Trustee is

vested with the same power to avoid and recover transfers as a bankruptcy trustee. In fact, Movants' position shows that mandatory withdrawal is improper, as Movants raise no issue requiring interpretation outside of Title 11.

A. Consideration of Only Well-Established Title 11 Law Is Required

As a preliminary matter, SIPA is not only a securities statute. Instead, SIPA is a hybrid statute; that is, both a securities and a bankruptcy law. *See In re BLMIS*, 654 F.3d 229, 242 n.10 (2d Cir. 2011) ("A SIPA liquidation is a hybrid proceeding."). SIPA is supported "by both the bankruptcy provision in the United States Constitution and also by the commerce clause." *SEC v. Albert & Maguire Sec. Co.*, 378 F.Supp. 906, 911 (E.D. Pa. 1974). Although the provisions of the Securities Exchange Act of 1934 ("1934 Act") apply as if SIPA were a part of the 1934 Act, they apply only "except as otherwise provided in [SIPA]." SIPA § 78bbb. The "except as otherwise provided in SIPA" refers to the incorporation of Title 11 provisions into the SIPA proceeding under SIPA section 78fff(b).

Moreover, as previously mentioned, a SIPA liquidation is conducted not only in accordance with, but *as though* it were being conducted under, specified provisions of the Bankruptcy Code, to the extent consistent with SIPA. SIPA § 78fff(b). One of those Bankruptcy Code provisions is section 550, governing the recovery of avoidable transfers from subsequent transferees.

Ignoring the recovery nature of the action against them, Movants seek to reargue avoidance issues that do not apply. Further, assuming, *arguendo*, that the avoidance provisions applied, the Trustee is not seeking an expansion of section 548 or otherwise, contrary to Movants' assertions. To limit the Trustee in his ability to recover assets is inconsistent with not only the Bankruptcy Code, but with his obligation to liquidate the Debtor and in the process, to

resolve all claims against the Debtor by satisfying claimants to the maximum extent possible. *See, e.g.*, SIPA § 78fff(a)(1)(B) (stating that the purposes of a SIPA liquidation is "to distribute customer property and . . . otherwise satisfy net equity claims of customers . . . .").

B. Section 546(e) of the Bankruptcy Code Does Not Apply

Section 546(e) of Title 11, the "stockbroker defense," provides a "safe harbor" by exempting from avoidance certain types of payments commonly made in connection with transactions in the securities markets. Movants rely upon that portion of section 546(e) that provides that notwithstanding specified provisions under the Code, but, tellingly, not including section 550, "the trustee may not avoid a transfer that is ... a settlement payment … made by or to ... [a] stockbroker [or] financial institution, ... in connection with a securities contract, as defined in section 741(7), ... that is made before the commencement of the case, except under section 548(a)(1)(A) of this title." Movants contend that, under section 546(e), the transfers of BLMIS customer property that they received cannot be avoided or recovered except pursuant to the "intentional fraudulent transfer" provisions of section 548(a)(1)(A). They are mistaken.

As an initial matter, section 546(e) does not present an issue worthy of mandatory withdrawal, as section 546(e) is a provision of Title 11. Determining whether section 546(e) applies requires consideration of Title 11, and not of any other law. *See, e.g.*, *Picard v. Merkin (In re BLMIS)*, 2011 WL 3897970, at *12 (S.D.N.Y. Aug. 31, 2011) (refusing to dismiss, at the pleading stage, a fraudulent transfer action on the grounds of a section 546(e) defense); *Jackson v. Mishkin (In re Adler, Coleman Clearing Corp.*), 263 B.R. 406, 471-484 (S.D.N.Y. 2001) (holding that certain trades did not constitute "settlement payments" under the Bankruptcy Code and section 546(e)); *Gredd v. Bear Stearns Sec. Corp. (In re Manhattan Fund),* 359 B.R. 510, 516 (Bankr. S.D.N.Y.), *aff'd in part and rev'd in part*, 397 B.R. 1 (S.D.N.Y. 2007) (stating that

section 546(e) prevents the avoidance of margin payments except when actual fraud is present); *Kipperman v. Circle Trustee F.B.O. (In re Grafton Partners*), 321 B.R. 527, 539 (9th Cir. BAP 2005) ("The few decisions that involve outright illegality or transparent manipulation reject § 546(e) protection"); *Wider v. Wootton*, 907 F.2d 570, 572 (5th Cir. 1990) (holding section 546(e) inapplicable to customers of a Ponzi scheme).

Moreover, applying section 546(e) as contemplated by Movants would contravene its purposes. The provision was intended "to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." H. R. Rep. No. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583.[8] Congress sought to prevent the "ripple effect" created by "the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market." *Bevill, Bresler & Schulman Asset Mgt. Corp. v. Spencer Sav. & Loan Ass'n*, 878 F.2d 742, 747 (3d Cir. 1989). *See Enron Corp. v. Bear, Stearns Int'l Ltd. (In re Enron Corp.)*, 323 B.R. 857, 864 (Bankr. S.D.N.Y. 2005) ("The purpose of section 546 is 'to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions.'[citation omitted]"). Where, as here, no securities transactions were effected, there is no possible market disruption or "ripple effect."

Finally, the Trustee's action against the Movants seeks the recovery of subsequent transfers pursuant to section 550(a), not the avoidance of the underlying initial transfers. As a

[8] Section 546(e) was amended under the Financial Netting Improvements Act of 2006, to include the language relied upon by Movants. *See* Pub. L. No. 109-390, §5(b)(1), 120 Stat. 2692, 2697-2698 (2006). The amendment did not alter the fundamental purpose of the section, namely, to address the risk that the failure of one financial entity would disrupt or endanger the financial markets. H.R. Rep. No. 109-648 (part 1) at 3 (2006), *reprinted in* 2006 U.S.C.C.A.N. 1585, 1587.

result, section 546(e), which applies, at best, only to certain avoidance actions brought pursuant to sections 544, 545, 547, 548(a)(1)(B), and 548(b), does not apply here. *See Picard v. Katz*, __ F. Supp. 2d __, 2012 WL 127397, at *6 (S.D.N.Y. Jan. 17, 2012).

C. Congress Affirmatively Intended to Extend the Court's Jurisdiction to All Customer Property, Wherever Located

Movants also contend that the claims against them involve the extraterritorial application of the avoidance provisions, which is prohibited by the Supreme Court's recent decision in *Morrison v. Nat'l Austl. Bank Ltd.*, __ U.S. __, 130 S.Ct. 2869 (2010) ("*Morrison*"), and, in any event, will require interpretation of SIPA. This contention reflects a failure to understand the nature of the recovery sought by the Trustee, a failure to appreciate that the applicable provisions of SIPA arise out of and explicitly refer to the provisions of Title 11, and a misreading of both SIPA and the Bankruptcy Code.

In *Morrison*, the Supreme Court held that there is a presumption against the extraterritorial application of a statute unless "'the affirmative intention of the Congress is clearly expressed' to give a statute extraterritorial effect." 130 S.Ct. at 2877 (*quoting EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 248 (1991)). In the present case, through this law suit, the Trustee seeks to recover what SIPA characterizes as "customer property *of the debtor*." *See* SIPA § 78fff-2(c)(1) (emphasis added). In fact, SIPA provides expressly that "the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property…" and that "[f]or purposes of such recovery, *the property so transferred shall be deemed to have been the property of the debtor*." *See* SIPA § 78fff-2(c)(3) (emphasis added). As deemed property of the Debtor, the property that the Trustee seeks to recover is also "property of the estate" within the meaning of Bankruptcy Code section 541(a)(1). *See* 11 U.S.C. § 541(a)(1) (property of the estate includes "all legal or equitable interests of the debtor in

property as of the commencement of the case").

Both SIPA and the Bankruptcy Code make clear that the Bankruptcy Court has exclusive jurisdiction over such property, wherever located and by whomever held. SIPA, for example, provides that the Bankruptcy Court "shall have exclusive jurisdiction of such [SIPA] debtor and its property wherever located (*including property located outside the territorial limits of such court*…)." *See* SIPA § 78eee(b)(2)(A) (emphasis added). In the same vein, the Bankruptcy Code defines property of the estate to include property of the debtor "wherever located and by whomever held," while the section of Title 28 providing for federal jurisdiction over bankruptcy matters confers jurisdiction over "all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate." *See* 11 U.S.C. § 541; 28 U.S.C. § 1334(e)(1). As this Court and others have recognized, that Congress intended the latter provision to have extraterritorial application is not in question. *See, e.g., In re Globo Comunicacoes e Participacoes S.A.*, 317 B.R. 235, 250-51 (S.D.N.Y. 2004) (collecting cites for the proposition that Congress intended 28 U.S.C. § 1334(e)(1) "to have global reach"). Given the plain language of both section 78eee(b)(2)(A) of SIPA and section 541 of the Bankruptcy Code, and the close similarity between the language of those provisions and the language of 28 U.S.C. § 1334(e)(1), it is equally clear that Congress intended for all of these provisions to have extraterritorial effect. As a consequence, the extraterritoriality argument raised by Movants presents no substantial issue of non-Title 11 law, and, instead, can and should be resolved by the Bankruptcy Court.

IV. ***STERN v. MARSHALL*** **DOES NOT MANDATE WITHDRAWAL**

Movants argue that the Bankruptcy Court lacks the authority to adjudicate the recovery action if a claim was not filed. *See* Memorandum, filed October 31, 2011, Case No. 11-cv-07763 [Docket No. 3], at 11-12 *and* Memorandum, filed October 31, 2011, Case No. 11-cv-

07810 [Docket No. 3], at 11-12, *citing, e.g., Samson v. Blixseth (In re Blixseth)*, 2011 WL 3274042, at *12 (Bankr. D. Mont. Aug. 1, 2011. Movants advocate for an expansive reading of *Stern* that was applied in cases such as *Blixseth*, but criticized by other courts. *See, e.g., Heller Ehrman LLP v. Arnold & Porter LLP (In re Heller Ehrman LLP)*, __ F. Supp. 2d __, 2011 WL 6179149, at **6-7 (N.D. Cal. Dec. 13, 2011); *McCarthy v. Wells Fargo Bank, N.A. (In re El-Atari)*, 2011 WL 5828013, at **4-5 (E.D. Va. Nov. 18, 2011). For example, in *Heller Erhman*, Judge Breyer rejected the court's holding in *Blixseth* and held that the bankruptcy court is the proper court to make proposed findings of fact and conclusions of law on a fraudulent transfer claim when the defendant did not file a claim in the bankruptcy proceeding. Thus, even assuming, *arguendo*, that the Court's holding in *Stern v. Marshall*, __ U.S. __, 131 S. Ct. 2594 (2011), stripped non-Article III courts from issuing final judgment on these core claims, that holding would not prevent the Bankruptcy Court from acting as a magistrate judge. *In re Extended Stay*, 2011 WL 5532258, at *7 (S.D.N.Y. Nov. 10, 2011) ("In the event that the bankruptcy court does not have constitutional authority to enter a final judgment on certain claims, it may submit proposed findings of fact and conclusions of law to this Court."); *see* Amended Standing Order issued by this Court on February 1, 2012. Accordingly, withdrawal of the reference is not required at this time.

V. SLUSA IS INAPPLICABLE

Movants' contention that SLUSA creates issues that mandate withdrawal of the reference here is also unfounded. Congress enacted SLUSA as part of the Private Securities Litigation Reform Act of 1995 in order to prevent securities class action plaintiffs from suing under state law so as to circumvent the stringent pleading requirements imposed on claims brought under the federal securities laws. *See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 82 (2006); *Anwar v. Fairfield Greenwich Ltd.*, 728 F.Supp.2d 372, 398 (S.D.N.Y. 2010) ("*Anwar*").

Under SLUSA, claims that: (1) are brought by a private party in a "covered class action;" (2) are based upon state or local law;[9] (3) allege the misrepresentation or omission of a material fact "in connection with" the purchase or sale of (4) a "covered security," are preempted by SLUSA and subject to dismissal. *See, e.g., Romano v. Kazacos*, 609 F.3d 512, 517-18 (2d Cir. 2010); *Anwar*, 728 F.Supp.2d at 398. In this case, none of these elements is met.

A. <u>There Is No Covered Class</u>

SLUSA defines a "covered class action" to include a single lawsuit in which "damages are sought on behalf of more than 50 persons or prospective class members…" and in which "questions of law or fact common to those persons…predominate." *See* 15 U.S.C. §§ 77p(f)(2)(A)(i)(I); 78bb(f)(5)(B)(i)(I). SLUSA further provides that, in counting putative class members, an entity "shall be treated as one person or prospective class member, but only if the entity is not established for participating in the action." *See* 15 U.S.C. §§ 77p(f)(2)(C); 78bb(f)(5)(D). As this language indicates, unless an entity, including a trusteeship, is established for the purpose of bringing the claims in question, the Court cannot "look through" that entity to those who might benefit from its action, and instead must treat the entity as a single person in counting putative class members for purposes of the "covered class action" provisions. *Id.*

As the legislative history to SLUSA explains, Congress enacted this "entity exception," *inter alia*, to ensure that a trustee, among others, would be able to sue third parties to recover property of the estate. *See* S. Rep. No. 105-182, at 8 (1998) ("[A] trustee in bankruptcy . . . would not be covered by this provision."); *see also LaSala v. Bordier et Cie*, 519 F.3d 121, 132-33 (3d Cir. 2008) (holding that a bankruptcy trustee is a part of the "entity exception") *cert.*

[9] Because SLUSA only prohibits certain covered class actions brought under "statutory or common law of any State," SLUSA does not apply to causes of action brought by the Trustee under the Bankruptcy Code. 15 U.S.C. § 77p(f)(2)(A)(i)(I).

dismissed, 555 U.S. 1028 (2008); *Lee v. Marsh & McLennan Co.*, 2007 WL 704033, at * 4 (S.D.N.Y. Mar. 7, 2007) ("[A] typical Chapter 11 trust established to represent a bankrupt estate for all purposes, including the litigation of outstanding causes of action, is entitled to entity treatment.").

Because the Trustee was not appointed for the primary purpose of bringing and prosecuting his claims in this proceeding, the Trustee is a single person for purposes of counting putative class members and no "look-through" provision should be applied in making that computation. *See* 15 U.S.C. §§ 77p(f)(2)(C); 78bb(f)(5)(D); *LaSala v. TSB Bank*, 514 F.Supp.2d 447, 470-71 (S.D.N.Y. 2007); *Lee*, 2007 WL 704033, at * 4. *See also Bordier*, 519 F.3d at 132-33. The number of customers and/or other estate creditors who may benefit from a recovery by the Trustee thus is not pertinent here, and the Trustee's claims in this proceeding therefore cannot form part of a "covered class action."

B. <u>The Trustee Has Not Alleged Securities Fraud</u>

Moreover, SLUSA does not apply here because the Trustee has not alleged fraud "in connection with" the purchase or sale of a "covered security" within the meaning of SLUSA. The statute preempts only those claims for which allegations of "material misstatements or omissions" with respect to a "covered security" are necessary. *See, e.g., Anwar v. Fairfield Greenwich, Ltd.*, 728 F.Supp.2d 372, 399 n.7 (S.D.N.Y. 2010); *Xpedior Creditor Trust v. Credit Suisse First Boston (USA) Inc*., 341 F.Supp.2d 258, 266-70 (S.D.N.Y. 2004). As the Trustee has not alleged material misstatements or omissions in connection with the purchase or sales of covered securities, and need not do so in order to sustain his claims, the Trustee's claims fall outside the scope of SLUSA.

CONCLUSION

For all of the aforementioned reasons, the Motions should be denied.

Dated: Washington, D.C.
February 21, 2012

Respectfully submitted,

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES INVESTOR PROTECTION CORPORATION, Plaintiff-Applicant, v. BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Defendant.	Adv. Pro. No. 08-01789 (BRL) SIPA LIQUIDATION (Substantively Consolidated)
In re: BERNARD L. MADOFF, Debtor.	
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. EQUITY TRADING PORTFOLIO LIMITED *et al.*, Defendants.	Adv. Pro. No. 10-04457 (BRL) No. 11-cv-07810 (JSR)
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. OREADES SICAV REPRESNTED BY ITS LIQUIDATOR INTER INVESTISSEMENTS S.A., *et al.*, Defendants.	Adv. Pro. No. 10-5120 (BRL) No. 11-cv-07763 (JSR)

CERTIFICATE OF SERVICE

I, Kevin H. Bell, hereby certify that on February 21, 2012, I caused true and correct copies of the Memorandum of Law of the Securities Investor Protection Corporation in Opposition to Defendants' Motion to Withdraw the Reference to be served upon counsel for those parties who receive electronic service through ECF and by electronic mail to those parties as set forth on the attached Schedule A.

/s/ Kevin H. Bell
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Schedule A

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