**UNITED STATES DISTRICT COURT**
**SOUTHERN DISTRICT OF NEW YORK**

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|---|---|
| SECURITIES INVESTOR PROTECTION CORPORATION,<br><br>Plaintiff-Applicant,<br>v.<br><br>BERNARD L. MADOFF INVESTMENT SECURITIES LLC,<br><br>Defendant. | Adv. Pro. No. 08-01789 (BRL)<br><br>SIPA Liquidation<br><br>(Substantively Consolidated)<br><br>Adv. Pro. No. 10-05345 (BRL) |
| In re:<br>BERNARD L. MADOFF,<br><br>Debtor. | |
| IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC,<br><br>Plaintiff,<br>v.<br><br>CITIBANK, N.A., CITIBANK NORTH AMERICA, INC., AND CITIGROUP GLOBAL MARKETS LIMITED,<br><br>Defendants. | 11 Civ. 07825 (JSR) |

**TRUSTEE'S MEMORANDUM OF LAW IN OPPOSITION TO CITIGROUP GLOBAL MARKETS LIMITED'S MOTION TO DISMISS PURSUANT TO SECTION 546(g) OF THE BANKRUPTCY CODE**

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Irving H. Picard ("Trustee"), as Trustee for the substantively consolidated liquidation of the business of Bernard L. Madoff Investment Securities LLC ("BLMIS") under the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa, *et seq*. ("SIPA"), and the estate of Bernard L. Madoff ("Madoff"), by his undersigned counsel, respectfully submits this memorandum of law in opposition to the motion by Citigroup Global Markets Limited ("Citigroup Global") to dismiss the Trustee's Complaint, styled *Picard v. Citibank, N.A., Citibank North America, Inc., and Citigroup Global Markets Limited*, Adv. Pro. No. 10-5345 (BRL), based on Section 546(g) of the Bankruptcy Code (the "Motion").

## PRELIMINARY STATEMENT

Citibank, N.A., Citibank North America, Inc., and Citigroup Global (the "Defendants") are the recipients of subsequent transfers of approximately $425 million of BLMIS customer property that was fraudulently transferred in connection with Madoff's massive Ponzi scheme. Through this action, pursuant to Section 550 of the Bankruptcy Code, the Trustee seeks to recover those stolen customer funds Defendants received under circumstances which they either knew, or should have known, of possible fraudulent activity at BLMIS.

On its present Motion, Defendant Citigroup Global seeks dismissal of a portion of the Trustee's claims that relate to certain subsequent transfers of customer property that it argues BLMIS made "in connection with" a swap agreement and fall within a statutory safe harbor set forth in Section 546(g) of the Bankruptcy Code ("Section 546(g)"). But as set forth in detail below, this statutory defense is by its express terms unavailable to subsequent transferees, such as Citigroup Global.

The text of Section 546(g) clearly and unambiguously provides a safe harbor only with respect to avoidance actions brought against initial transferees who received fraudulent transfers from a debtor. According to its plain language, Section 546(g) does not apply to preclude

recovery actions against subsequent transferees under Section 550 of the Bankruptcy Code. Of course, were the safe harbor defense available to the initial transferee to preclude avoidance of the initial fraudulent transfer, then that same defense would preclude the Trustee's action to recover any portion of that initial transfer subsequently transferred to Citigroup Global. The converse, however, is also true—if a defense is unavailable to the initial transferee to preclude the Trustee's avoidance action, then that same defense is unavailable to subsequent transferees in a recovery action.

That is precisely why the safe harbor is unavailable to Citigroup Global here: it is not available to the initial transferee. As set forth below, neither BLMIS nor the initial transferee, Fairfield Sentry Limited ("Sentry"), was party to any swap agreement. Rather, Sentry was a feeder fund that held customer accounts at BLMIS, and the initial fraudulent transfers from BLMIS to Sentry were made in connection with Sentry's requests for withdrawals from its customer accounts. On these facts, the safe harbor of Section 546(g) is completely inapplicable to preclude avoidance of the initial fraudulent transfers BLMIS made to Sentry and, accordingly, Citigroup Global cannot invoke this safe harbor as a defense to the Trustee's action to recover the portion of these fraudulent transfers it subsequently received. Though Citigroup Global asserts that it is "of no moment" that the initial transfers from BLMIS were made to Sentry and not to Citigroup Global, this is the dispositive fact on this Motion.

In its attempt to squeeze into the ambit of the Section 546(g) safe harbor, Citigroup Global asserts in its Motion that the subsequent transfers it received were made "in connection with" a swap agreement to which it was a party. But Citigroup Global is making the commonplace error of conflating the two separate concepts of avoidance and recovery under the Bankruptcy Code. The Trustee is not seeking to avoid any subsequent transfers to Citigroup

Global, but rather only to recover pursuant to Section 550 the portion of the initial fraudulent transfers Citigroup Global received. A close review of the Complaint reveals that BLMIS did not make any fraudulent transfers to Citigroup Global, let alone any transfers that were "in connection with" a swap.

Finally, recognizing the Section 546(g) safe harbor applies only to prevent the avoidance of certain initial transfers, Citigroup Global asserts that it is not a subsequent transferee but instead is a "for the benefit of" initial transferee. Once again, Citigroup Global confuses initial fraudulent transfers made by BLMIS with the subsequent transfers it received from Sentry, who dealt directly with BLMIS. There are no allegations that BLMIS was even aware that Citigroup Global invested in Sentry or that Citigroup Global participated in any swap agreement with third parties—and thus, there is no possible way BLMIS could have made the fraudulent transfers to Sentry "for the benefit of" Citigroup Global "in connection with" a swap. Moreover, because Citigroup Global actually received a portion of BLMIS's fraudulent transfers to Sentry, as a matter of law, Citigroup Global cannot be considered a "for the benefit of" initial transferee. As a result, Citigroup Global cannot qualify for the Section 546(g) safe harbor.

## **FACTUAL BACKGROUND**

This adversary proceeding is part of the Trustee's continuing efforts to recover BLMIS Customer Property[1] that was stolen as part of the massive Ponzi scheme perpetrated by Madoff and others. (Compl. at ¶ 1.) In this action, the Trustee seeks to recover approximately $430 million in subsequent transfers of Customer Property received by Defendants, who at all relevant times were part of a sophisticated global financial network that provided banking services and products to retail, private, and commercial banking clients. (*Id.* at ¶¶ 2, 5, 54, 55.)

[1] Terms not defined herein have the same meaning prescribed in the Complaint.

Approximately $130 million of the subsequent transfers received by Defendant Citigroup Global are at issue in this Motion.[2]

**The Initial Transfers**

The subsequent transfers of Customer Property received by Citigroup Global originated from initial transfers made by BLMIS to Sentry, a BLMIS Feeder Fund that invested all or nearly all of its assets in BLMIS direct customer accounts at BLMIS's IA Business. (*Id.* at ¶¶ 14, 16, 17, 20, 58.) The initial fraudulent transfers of Customer Property relevant to this Motion were made by BLMIS to Sentry in connection with Sentry's direct customer relationship with BLMIS. (*Id.* at ¶¶ 20, 58.) Specifically, in the six years prior to the Filing Date, BLMIS fraudulently transferred approximately $3 billion of Customer Property to Sentry (the "Initial Transfers"). (*Id.* at ¶ 184.) As described more fully below, portions of those Initial Transfers were subsequently transferred to Citigroup Global. (*Id.* at ¶¶ 18, 118, 123, 187, 189.)

**The Swaps**

Prior to April 2005, Auriga International Limited ("Auriga") entered into a swap agreement with Bank of America ("BOA") under which Sentry was the reference asset. (*Id.* at ¶¶ 87, 103, 104.) Presumably to hedge its risk under the swap agreement, BOA purchased Sentry shares. (*Id.* at ¶ 104.)

In 2005, BOA chose to terminate the swap with Auriga. (*Id.* at ¶ 87.) Auriga sought a new leverage provider and on April 28, 2005, Citigroup Global entered into a swap agreement with Auriga under which Citigroup Global agreed to provide Auriga with an amount equal to

[2] This action also seeks to recover approximately $300 million of Customer Property received by Rye Select Broad Market Prime Fund, a BLMIS feeder fund, which was subsequent transferred to Defendant Citibank N.A. or Citibank North America, Inc. (*Id.* at ¶¶ 14, 84, 174.) Such transfers, however, are not at issue in this Motion.

two times the return on a hypothetical investment in Sentry (the "Swap"). (*Id.* at ¶¶ 102, 103.) Under the terms of the Swap, Auriga paid Citigroup Global over $140 million as the initial collateral for the transaction (the "Collateral"). (*Id*. at ¶ 103.)

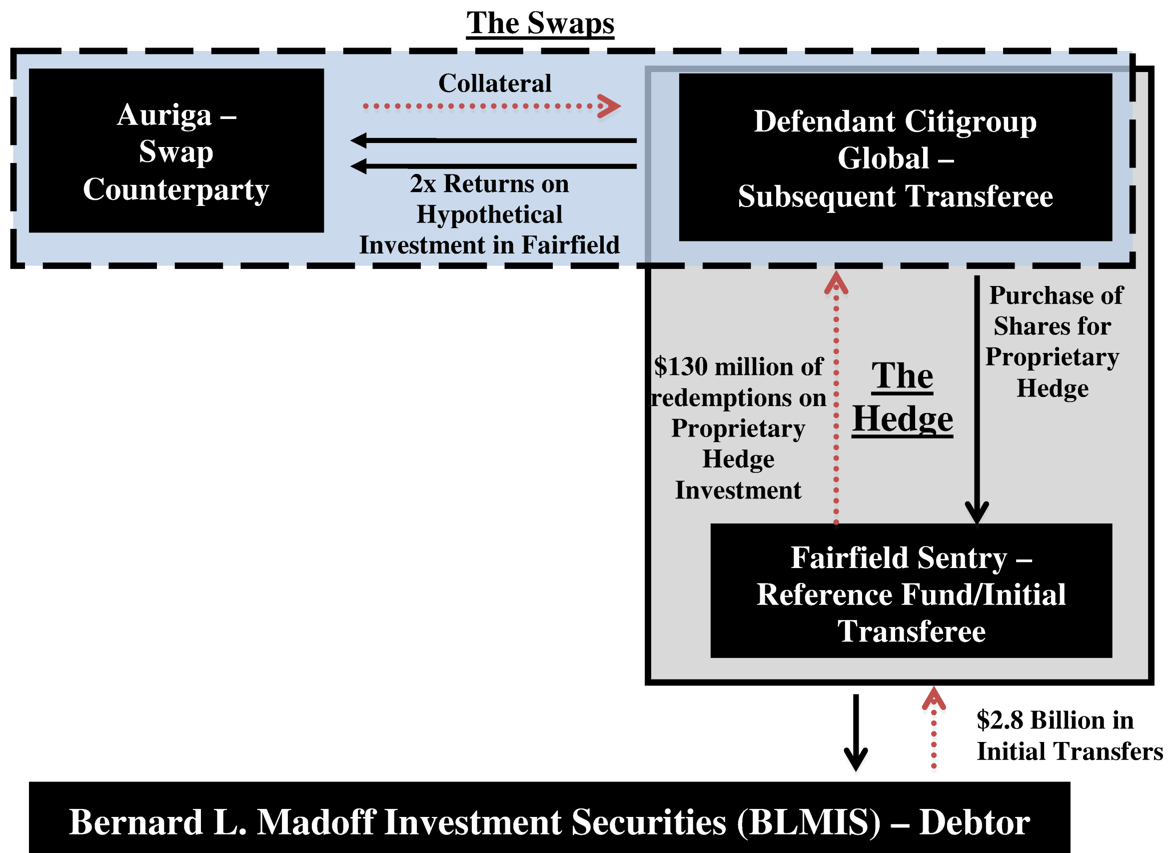
Citigroup Global was free to generate the returns owed to Auriga under the Swap in any way it saw fit. (*Id.* at ¶¶ 11, 102.) For example, it could have invested in other hedge funds, bonds, or even its own operations. Citigroup Global, nevertheless, chose to purchase shares of Sentry. (*Id.* at ¶¶ 18, 103, 104.) Rather than purchasing the shares directly from Sentry, Citigroup Global purchased Sentry shares from BOA upon the termination of BOA's Auriga swap. (*Id.*) BOA and Citigroup Global received Sentry's authorization to transfer the ownership of the Sentry shares from BOA to Citigroup Global. (*Id.* at ¶¶ 102, 103, 104.) In making the proprietary and unilateral decision to hedge its risk under the Swap by investing two times the Collateral received from Auriga in Sentry, Citigroup Global had a "perfect hedge" against what it owed to Auriga under the Swap. (*Id.*)

On May 2, 2007, Citigroup Global entered into another swap agreement with Auriga (the "Amended Swap" and, together with the Swap, the "Swaps"), replacing the existing Swap. (*Id.* at ¶ 113.) Under the Amended Swap, Citigroup Global continued to provide Auriga with an amount equal to two times the return on a hypothetical investment in Sentry. (*Id.* at ¶ 114.) In exchange, Auriga paid Citigroup Global interest amounting to LIBOR plus 140 basis points as well as structuring fees, technical fees, and exit fees. (*Id.* at ¶ 115.) The Amended Swap was scheduled to terminate on April 28, 2014. (*Id.*) After entering the Amended Swap, Citigroup Global maintained its investment in Sentry, hedging its risk under the Amended Swap. (*Id.* at ¶ 114.)

**The Subsequent Transfers Relevant To The Motion**

At all relevant times, Citigroup Global was simply another investor in Sentry and, as such, was free to unilaterally redeem its shares as it wished. (*Id.* at ¶¶ 11, 23, 102.) Under the Swaps, Citigroup Global was in no way obligated to invest in or redeem its Sentry shares. (*Id.*) Any decisions to do so were independent and proprietary decisions made by Citigroup Global. (*Id.*) Citigroup Global redeemed $30 million of Sentry shares on October 14, 2005 (*id.* at ¶ 191), $60 million of Sentry shares on April 14, 2008 (*id.* at ¶¶ 118, 191, 192), and $40 million of Sentry shares on November 19, 2008 (*id.* at ¶¶ 123, 192, 193). As set forth in the Complaint, Sentry satisfied Citigroup Global's redemptions with funds withdrawn from Sentry's BLMIS accounts, taking portions of these Initial Transfers of Customer Property and subsequently transferring them to Citigroup Global. (*Id.* at ¶¶ 20, 187, 189.)

The chart below shows the initial and subsequent transfers detailed in the Complaint and at issue in this Motion:



## LEGAL STANDARD

In determining whether a motion to dismiss should be granted, a court must analyze whether a complaint contains "sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). "When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief." *Id.*, 556 U.S. at 679. In considering a motion to dismiss under Federal Rule of Civil Procedure ("FRCP") 12(b)(6), "[t]he Court's function . . . is 'not to weigh the evidence that might be presented at [a] trial but merely to determine whether the complaint itself is legally sufficient.'" *Jenkins v. New York City Transit Auth.*, 646 F.Supp.2d 464, 467 (S.D.N.Y. 2009) (quoting *Goldman v. Belden*, 754 F.2d 1059, 1067 (2d Cir. 1985)).

Under FRCP 8(a), all that is required is that the complaint give the opposing party "fair notice of what the . . . claim is and the grounds upon which it rests." *Silverman v. K.E.R.U. Realty, Corp. (In re Allou Distribs.)*, 379 B.R. 5, 31 (Bankr. E.D.N.Y. 2007) (quoting *Erickson v. Pardus*, 551 U.S. 89, 93 (2007)) (ellipsis in original). A complaint satisfies the pleading requirement of FRCP 8(a) if it contains sufficient factual allegations to enable a defendant to respond. *See* 5 Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1215 (3d ed. 2012).

*Iqbal* and *Twombly* do not create a heightened standard of pleading, but instead require that a plaintiff include sufficient, specific factual allegations so as "to render [a] claim plausible." *Boykin v. KeyCorp*, 521 F.3d 202, 213 (2d Cir. 2008) (emphasis in original). Put another way, a complaint need plead "only enough facts to state a claim to relief that is plausible on its face." *Twombly*, 550 U.S. at 570.

Courts in this Circuit have held that affirmative defenses, including the "safe harbors" contained in Section 546(e)-(j) of the Bankruptcy Code, are inappropriate on a motion to dismiss. *See Picard v. Merkin (In re Bernard L. Madoff Inv. Secs.)*, 440 B.R. 243, 256 (Bankr. S.D.N.Y. 2010) (*Merkin I)* (good faith defense is an affirmative defense that a transferee must raise and prove at trial); *Enron Corp. v. Bear, Stearns Int'l Ltd. (In re Enron Corp.)*, 323 B.R. 857, 870 (Bankr. S.D.N.Y. 2005) (safe harbor defense cannot be raised on a motion to dismiss unless defense appears on the face of the complaint); *see also Degirolamo v. Truck World, Inc. (In re Laurel Valley Oil Co.)*, No. 07-6109, 2009 WL 1758741, at *3 (Bankr. N.D. Ohio June 16, 2009). The only exception is where the defense appears "on the face of the Complaint." *See Gowan v. The Patriot Group LLC (In re Dreier LLP)*, 452 B.R. 391, 427 (Bankr. S.D.N.Y. 2011) ("[A] complaint may be subject to dismissal under Rule 12(b)(6) when an affirmative defense appears on its face") (quoting *Feldman v. Chase Home Fin., Inc. (In re Image Masters, Inc.)*, 421 B.R. 164, 181 (Bankr. E.D. Pa. 2009)).

Here, each of the Trustee's claims is legally sufficient and utterly plausible, and the Section 546(g) affirmative defense is not applicable on the face of the Complaint.[3] Accordingly, Defendant Citigroup Global's Motion should be denied.

[3] Pursuant to this Court's order withdrawing the reference, the only issue on this Motion is the applicability of the Section 546(g) safe harbor. To the extent Citigroup Global references any other issues in its Motion, including any challenges to the so-called "plausibility" of the Complaint allegations, the Trustee reserves his rights to address all such issues at the appropriate time.

## ARGUMENT

### I. SUBSEQUENT TRANSFEREE DEFENDANTS CANNOT TAKE ADVANTAGE OF SECTION 546(g) WHERE THAT SAFE HARBOR IS NOT AVAILABLE TO PRECLUDE AVOIDANCE OF THE INITIAL FRAUDULENT TRANSFER

#### A. Section 546(g) Applies Only To Preclude Avoidance Of Initial Transfers From The Debtor

The plain language of the Section 546(g) safe harbor itself reveals that it is not applicable to the Trustee's recovery claims against Citigroup Global under Section 550 of the Bankruptcy Code.[4]

Section 546(g) provides, in pertinent part, that:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B) and 548(b) of this title, the trustee may not avoid a transfer, made by or to (or for the benefit of) a swap participant or financial participant, under or in connection with any swap agreement and that is made before the commencement of the case, except under 548(a)(1)(A) of this title.[5]

The specific actions referred to by Section 546(g) as being precluded by the safe harbor—actions brought pursuant to Bankruptcy Code Sections 544, 545, 547 and 548—are actions which seek to avoid fraudulent transfers made by a debtor of its property to initial transferees.[6] Notably absent from the actions enumerated in Section 546(g) are actions brought pursuant to Section 550, which seek to recover fraudulent transfers either directly from the initial

[4] The starting point for any question of statutory construction is the language of the statute itself. *See Blum v. Stenson*, 465 U.S. 886, 896 (1984).

[5] 11 U.S.C. § 546(g) (emphasis added).

[6] *See* 11 U.S.C. §§ 544 ("The Trustee…may avoid any transfer of property of the debtor…"); 545 ("The Trustee…may avoid the fixing of a statutory lien on property of the debtor…"); 547 ("The Trustee may avoid any transfer of an interest of the debtor in property…"); 548 ("The Trustee may avoid any transfer…of an interest of the debtor in property…") (emphasis added).

transferee or, as here, from subsequent transferees who received some or all of the initial fraudulent transfers.[7]

At bottom, Citigroup Global is arguing that the subsequent transfers of Customer Property that Sentry made to Citigroup Global were made "in connection with" a swap and, therefore, fall within the scope of Section 546(g).[8] But a point often overlooked—as Citigroup Global does here[9]—is that recovery actions under Section 550 do not avoid subsequent transfers; they seek to recover all or a portion of an initial fraudulent transfer of the debtor's property. *See* 11 U.S.C. §§ 550(a) and (b). Thus, by attempting to draw the focus to the subsequent transfers Sentry made to Citigroup Global and away from BLMIS's initial fraudulent transfers to Sentry, Citigroup Global is improperly conflating the Bankruptcy Code's distinct and separate concepts of avoidance and recovery. *See* S. REP. NO. 95-989, at 90 (1978) (Section 550 "enunciates the separation between the concepts of avoiding a transfer and recovering from the transferee . . . or

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[7] *See IBT Int'l, Inc. v. Northern (In re Int'l Admin. Servs., Inc.)*, 408 F.3d 689, 706 (11th Cir. 2005) ("[O]nce the plaintiff proves that an avoidable transfer exists he can then skip over the initial transfers and recover from those next in line."); *Picard v. Greiff (In re Madoff Secs.)*, No. 12 MC 115 (JSR), 2012 WL 1505349, at *6 (S.D.N.Y. Apr. 30, 2012) ("[W]here the Trustee can avoid an initial transfer under § 548(a)(1)(A), § 550(a) then allows the Trustee to recover 'the property transferred' from 'any immediate or mediate transferee of [the] initial transfer.'") (alteration in original) (quoting 11 U.S.C. § 550(a)).

[8] *See, e.g.*, Def's. Br. at 1 ("The plain language of the section 546(g) safe harbor protects from avoidance (and therefore recovery) transfers allegedly received by CGML 'in connection with' a 'swap agreement' to which CGML was a party."); at 5 ("The Plain Language Of Section 546(g) Applies To The Transfers Allegedly Made To CGML 'In Connection With' The Auriga Swap") (emphasis added).

[9] *See, e.g.*, Def's. Br. at 1 ("The Trustee is thus barred from avoiding and recovering the challenged transfers . . ."); at 11 ("[T]he Trustee cannot avoid any transfers allegedly received by CGML . . .").

from any immediate or mediate transferee").[10] This separation of the concepts of avoidance and recovery is exemplified by the fact that the actions are provided for in separate sections of the Bankruptcy Code, and Congress specifically provided separate defenses for the two different actions, such as different affirmative defenses and statutes of limitations. *Compare* 11 U.S.C. §§ 546 and 548 *with* § 550(b), (f). Much like the good faith affirmative defense provided in Section 550(b), which is only available to shield subsequent transferees from a trustee's recovery powers,[11] the safe harbor for swap agreements provided in Section 546(g) is by its terms only available to shield avoidance of a debtor's fraudulent transfer to an initial transferee.

In prior filings with this Court, Citigroup Global acknowledged the separation of avoidance and recovery, and that the Section 546(e) and (g) safe harbors are applicable only as a defense to avoidance of a debtor's fraudulent transfers to initial transferees.[12] Now Citigroup Global conflates the two concepts and is essentially asking this Court to rewrite Section 546(g)—

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[10] *See also Savage & Assocs., P.C. v. BLR Servs. SAS, et al. (In re Teligent, Inc.)*, 307 B.R. 744, 749 (Bankr. S.D.N.Y. 2004) ("The Code separates the avoidance of a fraudulent transfer from the recovery of a fraudulent transfer."); *SIPC v. Stratton Oakmont, Inc.*, 234 B.R. 293, 312 (Bankr. S.D.N.Y. 1999) ("The statute clearly separates '(1) the initial transferee of such transfer . . .' from '(2) any immediate or mediate transferee of such initial transferee,' otherwise known as the subsequent transferee . . .") (quoting 11 U.S.C. § 550(a)(1) & (2)).

[11] *See Abele v. Modern Fin. Plans Servs., Inc. (In re Cohen)*, 300 F.3d 1097, 1102-03 (9th Cir. 2002) (the good faith defense set forth in Bankruptcy Code Section 550(b) is available exclusively to subsequent transferees and cannot be asserted by initial transferees); *Stratton Oakmont*, 234 B.R. at 312 ("[T]he liability to the estate of the initial transferee . . . is absolute . . . whereas the liability of the subsequent transferee to the estate is not strict but subject to the 'good faith purchaser for value' defense contained in § 550(b).") (internal citations omitted).

[12] *See* Mem. Of Law in Support of Defs.' Motion to Withdraw the Reference, at 7-8 [Dkt. No. 2] ("If these safe harbors apply, the Trustee, as a matter of law, cannot avoid transfers made from BLMIS to Sentry or Prime Fund [i.e., the initial transferees] prior to December 11, 2006, and therefore cannot recover these transfers from subsequent transferees like the Citi Defendants."); ("Sections 546(e) and (g) are two of several Bankruptcy Code provisions that prevent the avoidance of certain transfers and seek to balance the avoidance powers of the Trustee with the need to protect the securities and financial markets from disruption.") (emphasis added).

which is applicable only to avoidance actions—by inserting "Section 550" into the statute to make it applicable to recovery actions when Congress could have, but declined to do so.[13] But to do as Citigroup Global suggests and extend Section 546(g)'s safe harbor to recovery of subsequent transfers would require this Court to ignore the plain language of the statute and the Bankruptcy Code's recognized scheme bifurcating the concepts of avoidance and recovery.[14]

### B. The Section 546(g) Safe Harbor Is Unavailable To Shield The Avoidance Of The Initial Transfers Here, And Therefore Is Unavailable As A Defense In This Recovery Action

#### 1. *BLMIS Did Not Make Any Fraudulent Transfers To The Initial Transferee In Connection With A Swap Agreement*

Because Section 546(g) only applies to preclude avoidance of initial transfers made by a debtor, the only possible fraudulent transfers to which the safe harbor could apply in this case are the initial transfers from BLMIS to the initial transferee, Sentry. But under the allegations in the Complaint, the Section 546(g) safe harbor is not available to Sentry and, as a result, cannot be invoked by Citigroup Global.

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[13] *Craig v. Bosworth, Inc. (In re Am. Sec. & Loan, Inc.)*, Adv. Pro. No. 87-0288 (LMJ), 1988 WL 1568184, at *4 (Bankr. S.D. Iowa Sept. 30, 1988), cited by Citigroup Global, holds that a Trustee cannot recover an initial transfer under Section 550 that is protected from avoidance by the Section 546 safe harbors. *In re Am. Sec. & Loan, Inc.*, however, did not hold that Section 546 applies to bar recovery of a subsequent transfer where the safe harbor does not bar the avoidance of the initial transfer. Indeed, that case did not involve any subsequent transfers or subsequent transferees. Because the initial transfers from BLMIS to Sentry in the instant case are not protected from avoidance by Section 546(g), *In re Am. Sec. & Loan, Inc.*, is inapposite.

[14] Citigroup Global suggests that it would be "nonsensical" to abide by the plain language of the statute and refuse to apply Section 546(g) to a subsequent transferee because this somehow "would make a subsequent transferee more vulnerable to recovery than an initial transferee." (Def's. Br. at 9-10.) This argument ignores that Congress has already provided subsequent transferees with a specific defense to recovery actions in Section 550(b) relating to their level of knowledge concerning the debtor. *See* 11 U.S.C. § 550(b) (providing defense to recovery where subsequent transferee can prove he took for value, in good faith, and without knowledge of the voidability of the transfer avoided). In any event, knowledge of the debtor's financial situation is wholly irrelevant to Section 546(g)'s applicability.

As alleged in the Complaint, Sentry, the initial transferee, had customer accounts with BLMIS. It was in connection with Sentry's withdrawal requests from those customer accounts that BLMIS made the initial fraudulent transfers to Sentry. (Compl. at ¶¶ 20, 58, 182-86; *see also* Compl. Ex. C.) There is no allegation in the Complaint that BLMIS or Sentry was a party to a swap;[15] indeed, there is no allegation in the Complaint that BLMIS was aware of the Swaps or even Citigroup Global's investments in Sentry.[16] There is thus no plausible basis to assert that BLMIS made the fraudulent transfers to Sentry "in connection with" any swap agreement,[17] a

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[15] There appear to be no cases applying Section 546(g) where neither the debtor nor the initial transferee was a party to the swap at issue. Indeed, the only case applying Section 546(g) where the debtor was not a party to the swap at issue is *Peterson v. Enhanced Investing Corp. (Cayman) Ltd. (In re Lancelot Investors Fund, L.P.)*, 467 B.R. 643, 656 (Bankr. N.D. Ill. 2012), to which Citigroup Global cites. (*See* Def's. Br. at 8 n. 5.) But Citigroup Global's reliance on this case is misplaced. Unlike the facts here, the initial transfers made by the debtor in *In re Lancelot* were made to initial transferees in connection with a swap to which those initial transferees were parties. Moreover, while the debtor in *In re Lancelot Investors Fund* was not a party to the swap agreement, unlike the instant case, the debtor nevertheless expressly entered into an agreement with the swap counterparty, in which all parties acknowledged that the initial transferee's subscriptions in the debtor were "related" to the swap agreement at issue. *See* Mem. Of Law in Support of KBC's Motion for Summary Judgment, *In re Lancelot Investors Fund*, Adv. No. 10-1980 (Bankr. N.D. Ill. Oct. 21, 2011) [Dkt. No. 58] (providing further factual detail regarding the transactions at issue in *In re Lancelot Investors Fund*).

[16] Although not addressed by Citigroup Global in its Motion, Sentry cannot be considered a "swap participant" as set forth in Section 546(g) because Section 101(53C) of the Bankruptcy Code requires a "swap participant" to have "an outstanding swap agreement *with the debtor*." 11 U.S.C. § 101(53C) (emphasis added).

[17] Were this Court to find that the fraudulent transfers by BLMIS to Sentry, the initial transferee, were made "in connection with" the Swaps—which they were not—the factual issue remains as to whether Sentry qualifies as a Financial Participant under the definition provided in Section 101(22A) of the Bankruptcy Code. While Citigroup Global does not even attempt to argue that Sentry is a "financial participant," such a determination would require Citigroup Global to meet a very specific and detailed factual showing. Therefore, consideration of this issue is inappropriate at the pleading stage. *See, e.g.*, *Picard v. Merkin (In re Bernard L. Madoff Inv. Secs.)*, 440 B.R. 243, 256 (Bankr. S.D.N.Y. 2010) (*Merkin I*); *Enron Corp. v. Bear, Stearns Int'l Ltd. (In re Enron Corp.)*, 323 B.R. 857, 870 (Bankr. S.D.N.Y. 2005).

fact which Citigroup Global implicitly concedes because it does not even attempt to argue that the Section 546(g) safe harbor defense would be available to Sentry.

### 2. *Citigroup Global Cannot Disregard The Realities And Formalities Of The Parties' Distinct Transactions To Satisfy The "In Connection With" Requirement of Section 546(g)*

Citigroup Global tries to create the illusion that BLMIS made the initial fraudulent transfers to the initial transferee "in connection with" a swap by claiming that the "Complaint is also explicit that the transfers to Sentry were made 'in connection with' the Auriga Swap and 'for the benefit of' CGML." (Def's. Br. at 6 (citing Compl. at ¶¶ 2, 17, 264.)) Citigroup Global, however, misrepresents the allegations of the Complaint as those paragraphs to which it cites refer not to the initial transfers but solely to the subsequent transfers Sentry made to Citigroup Global. (*See id.*) Indeed, there is not a single allegation in the Complaint that BLMIS made the initial fraudulent transfers to Sentry "in connection with" any swap.[18]

At bottom, what Citigroup Global is really arguing is that it received the subsequent transfers from Sentry "in connection with" the Swap. But for the reasons set forth at length above, that argument again focuses on the wrong transfers—the subsequent transfers.

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[18] Citigroup Global also argues that a very broad interpretation of Section 546(g)'s "in connection with" requirement can somehow expand the scope of the safe harbor beyond its plain terms to cover subsequent transfers even where the initial transfers are not protected. (Def's. Br. at 7.) The cases cited by Citigroup Global, however, in no way support such a departure from the plain language of Section 546(g). In fact, the cases cited by Citigroup Global involve circumstances where the debtor and/or initial transferee were party to the swap agreement at issue. *See, e.g.*, *In re Casa de Cambio Majapara S.A. de C.V.*, 390 B.R. 595, 599 (Bankr. N.D. Ill. 2008) (involving prejudgment attachments stemming from the failure of a swap agreement between the debtor and the initial transferee); *Interbulk Ltd. v. Dreyfus Corp. (In re Interbulk)*, 240 B.R. 195, 202 (Bankr. S.D.N.Y. 1999) (involving initial transfers made in connection with a swap agreement between the debtor and the initial transferee); *In re Lancelot Investors Fund, L.P.*, 467 B.R. at 656 (involving initial transfers made in connection with a swap agreement between the initial transferee and third-party) (emphasis added). As discussed above, here neither the debtor—BLMIS—nor the initial transferee—Sentry—was party to any swap agreement.

Moreover, Citigroup Global's argument that the subsequent transfers were "in connection with" a swap erroneously presupposes that it is Citigroup Global's intent in receiving the subsequent transfers that governs the Section 546(g) analysis. But the only party's intent that is relevant to the question of what a fraudulent transfer was made "in connection with" is the debtor's fraudulent intent—not the intent of any transferee. *See Bayou Superfund, LLC v. WAM Long/Short Fund II, L.P. (In re Bayou Group, LLC)*, 362 B.R. 624, 631 (Bankr. S.D.N.Y. 2007) (holding only transferor's intent relevant in fraudulent transfer claim under Bankruptcy Code); *Silverman v. Actrade Capital, Inc. (In re Actrade Fin. Techs.)*, 337 B.R. 791, 808 (Bankr. S.D.N.Y. 2005) (same).

Here, BLMIS made the fraudulent transfers to Sentry, the initial transferee, and it is BLMIS's state of mind that governs what these transfers were made "in connection with." As alleged in the Complaint, BLMIS made the fraudulent transfers to Sentry "in connection with" its customer accounts. (Compl. at ¶¶ 20, 58, 182-86; *see also* Compl. Ex. C.) There is no allegation in the Complaint that BLMIS was aware of the Swaps at issue here or even Citigroup Global's investments in Sentry.[19] Thus, there is no basis to assert that BLMIS made the fraudulent transfers to Sentry "in connection with" any swap agreement.[20]

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[19] Indeed, Madoff made it clear to customers he was opposed to their use of leverage in connection with investments at BLMIS. (*See* Compl. at ¶ 4.)

[20] Any conceivable argument that the initial transfers here were made "in connection with" a swap because Citigroup Global's redemptions from Sentry were "motivated only by Auriga's desire to reduce the size of the swap" is flawed for the same reasons. (Def's. Br. at 4.) Citigroup Global's subjective motivation in making redemption requests from Sentry is irrelevant because it implicates the wrong party's intent—that of the subsequent transferee—when, as explained above, it is only the subjective intent of the debtor in making a fraudulent transfer that governs the Section 546(g) analysis. In any event, not a single allegation in the Complaint supports these supposed facts. In fact, Citigroup Global acknowledges it had full discretion over its investments in Sentry and could redeem its shares "at any time." (*Id.*)

Further, Citigroup Global's argument, which focuses on its perspective as a subsequent transferee, ignores the various parties' distinct business relationships and independent transactions as reflected in the chart set forth above. *See supra* p. 6. Sentry, the initial transferee, had a direct customer relationship with BLMIS and the fraudulent initial transfers that BLMIS made to Sentry were "in connection with" Sentry's independent decisions to withdraw funds from its BLMIS accounts. (Compl. at ¶¶ 20, 58, 182-86; *see also* Compl. Ex. C.) Citigroup Global had a direct investment relationship with Sentry governed by a subscription agreement between these two parties and any transfers that Sentry made to Citigroup Global were "in connection with" that investment relationship and agreement. (Compl. at ¶¶ 19, 23, 104, 118, 123, 191.) Finally, Citigroup Global entered into the Swaps with Auriga, an unrelated third-party. (Compl. at ¶¶ 102, 113.)

By focusing only on the subjective intent of the <u>recipient</u> of the subsequent transfers—Citigroup Global—it appears that Citigroup Global is effectively asking this Court to disregard all the formalities of the parties' independent relationships and separate transactions, and to "collapse" them. But each of the different transactions and relationships between the parties was unique, accompanied by different consequences, rights, and decision-making abilities. Citigroup Global cites no authority or reason for disregarding the reality of these distinct transactions—and particularly, for disregarding the reality of the transactions between BLMIS and Sentry, the initial transferee. Moreover, while collapsing of multilateral transactions may under certain circumstances be appropriate in determining whether a fraudulent transfer existed (*see, e.g.*, *HBE Leasing Corp. v. Frank*, 48 F.3d 623, 635 (2d Cir. 1995)), no court has ever used the doctrine to provide parties with a statutory defense that is by its plain terms unavailable to them.

**3. *Citigroup Global Is Not A "For The Benefit Of" Entity Entitled To Take Advantage Of The Section 546(g) Safe Harbor***

In its attempts to "leap frog" into initial transferee status in order to fall within the express terms of Section 546(g), Citigroup Global argues—without any legal or factual support—that the safe harbor should apply to it because the initial transfers from BLMIS to Sentry were made "for the benefit of" Citigroup Global. (Def's. Br. at 7.) In support of this argument, Citigroup Global again relies solely on allegations in the Complaint that refer exclusively to subsequent transfers that Sentry "made directly or indirectly to, or for the benefit of [Citigroup Global]."[21] (*See* Compl. ¶¶ 263-64, 272-73, 284-85, 293-95.) But once again, whether subsequent transfers may have been made "for the benefit" of Citigroup Global is irrelevant because Section 546(g) only protects avoidance of initial transfers that were made "for the benefit of" a swap participant or financial participant in connection with a swap agreement.[22]

Moreover, because Citigroup Global actually received Customer Property, as a matter of law, it is a subsequent transferee, not an entity for whose "benefit" BLMIS made the initial fraudulent transfers. "A subsequent transferee cannot be the entity for whose benefit the initial transfer was made. The structure of the statute separates initial transferee and beneficiaries, on

[21] As an initial matter, under Rule 8, "[a] party may set out 2 or more statements of a claim . . . alternatively or hypothetically, either in a single count or defense or in separate ones [and] . . . the pleading is sufficient if any one of them is sufficient." FRCP 8(d)(2); *see also Henry v. Daytop Village, Inc.*, 42 F.3d 89, 95 (2d Cir. 1994) ("[A] plaintiff may plead two or more statements of a claim, even within the same count, regardless of consistency."). Accordingly, even if Citigroup Global could be a "for the benefit of" entity, which it cannot, the Trustee has nevertheless also alleged that these subsequent transfers were made directly or indirectly to Citigroup Global.

[22] Citigroup Global cannot cite to any allegations in the Complaint that the initial transfers were made for its benefit because the initial transfers here were made by BLMIS to Sentry in connection with BLMIS's customer relationship with Sentry. (Compl. at ¶¶ 20, 58, 182-86; *see also* Compl. Ex. C.)

the one hand, from immediate or mediate transferees, on the other." *Bonded Fins. Servs. v. European Am. Bank*, 838 F.2d 890, 896 (7th Cir. 1988) (internal quotation marks omitted); *see also Christy v. Alexander & Alexander Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey)*, 130 F.3d 52, 57 (2d Cir. 1997), *cert denied* 524 U.S. 912 (1998) ("[W]e know that the 'entity for whose benefit' phrase does not simply reference the next pair of hands; it references entities that benefit as guarantors of the debtor, or otherwise, without ever holding the funds.").

Because Citigroup Global actually received proceeds from the initial fraudulent transfers over which it exercised dominion and control, Citigroup Global cannot be a "for the benefit of" entity:

> Logically, to benefit from the initial transfer cannot mean to exercise dominion and control over the money or property, or else the Bankruptcy Code would not have made a distinction between a transferee and the beneficiary of the initial transfer. Benefit occurs without the beneficiary ever holding the money or property, precisely because someone else received it.

*Stratton Oakmont*, 234 B.R. at 313 (emphasis added); *see also Lippi v. City Bank*, 955 F.2d 599, 611 (9th Cir. 1992) ("[A] subsequent transferee cannot be an entity for whose benefit the initial transfer was made, even if the subsequent transferee actually receives a benefit from the initial transfer.") (internal citations omitted); *Bonded*, 838 F.2d at 895 ("[s]omeone who receives the money later on is not an 'entity for whose benefit such transfer was made.'").

## II. EXPANDING SECTION 546(g) TO APPLY TO SECTION 550 RECOVERY ACTIONS CONTRARY TO ITS PLAIN TERMS IS NOT JUSTIFIED

Citigroup Global claims that the plain language of Section 546(g) is "dispositive, and obviates any need to consult legislative history." (Def's. Br. at 10.) Citigroup Global nevertheless argues that Section 546(g) should be construed broadly to apply to recovery actions to be consistent with the legislative purpose of the statute. (*See id.* at 10-11.) Even if the plain

text of the statute is ignored,[23] it is clear the safe harbor's underlying goal—to promote stability within the swap market by ensuring that a swap can terminate according to its terms and without any interference that could be caused by the bankruptcy of one of the swap parties—would not be furthered by applying the safe harbor here to shield recovery of the subsequent transfers at issue.

The legislative history of Section 546(g) reveals that Congress enacted the safe harbor to limit the Bankruptcy Code's impact on the process by which swap counterparties could terminate and "net" respective payments under a swap agreement—a fundamental feature of most swap agreements[24]—in the event one counterparty files for bankruptcy.[25] Congress recognized that this process is vital to swap market stability because otherwise, in the event of a bankruptcy of a swap party, swap transactions would remain open, leaving the non-defaulting party with substantial exposure to market risks and potentially volatile fluctuations in interest rates.[26]

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[23] *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. —, —, n. 3, 130 S.Ct. 1324, 1332, n. 3 (2010); *In re Baesa Secs. Litig.*, 969 F.Supp. 238, 241 (S.D.N.Y. 1997) ("When the statutory text is so plain, resort to legislative history is neither necessary nor prudent.").

[24] The termination and "netting" process typically means that if one party defaults, all transactions under the agreement terminate, and the parties' various payment obligations are netted to arrive at a single payment owed by the defaulting party to the non-defaulting party. *See Interest Swap: Hearing Before the Subcomm. On Courts and Admin. Practice of the Comm. on the Judiciary United States S.*, 101st Cong. 1 (1989) [hereinafter *1989 Hearing*] (Statement of Mark C. Brickell, Chairman, International Swaps and Dealers Association); H.R. REP. NO. 101-484, at 3 (1990) (noting that the setoff process is "at the center of a swap agreement").

[25] *See 1989 Hearing* (Statement of Sen. Charles E. Grassley, Member, S. Comm. on Courts and Admin. Practice) ("This bill ensures that, upon a bankruptcy filing by one party, the other party can close out all existing swap transactions with the bankrupt party. . . [and] ensures that all transactions between two parties can be netted out[.]"); S. REP. NO. 101-285, at 4 (1990) (noting that the swap safe harbors "would provide protection for the operation of interest rate and currency swap agreements when one of the parties files for bankruptcy protection").

[26] *See* S. REP. NO. 101-285, at 3-4 (1990) ("The immediate termination for default and the netting provisions are critical aspects of swap transactions and are necessary for the protection of all

Accordingly, Congress enacted Section 546(g) to "provide certainty for swap transactions and thereby stabilize domestic markets by allowing the terms of the swap agreement to apply notwithstanding the bankruptcy filing." 136 Cong. Rec. S7534 (1990) (statement of Sen. DeConcini).

The statute's clear purpose of protecting the swap termination process is not implicated here given the remoteness of the Swaps in question to the debtor. Neither Citigroup Global nor Auriga—the parties to the Swaps—filed for bankruptcy. Nor was BLMIS a party to the Swaps or any ancillary agreement thereto. Thus, the ability of the parties to terminate the Swaps was unaffected by BLMIS's bankruptcy and could be accomplished without intrusion by the Bankruptcy Code.[27]

Citigroup Global also argues that the Trustee "is wrong in trying to limit section 546(g)'s applicability solely to the avoidance of initial transfers, a limitation not found in the statue [sic] or legislative history, in light of the clear Congressional desire to protect broadly from avoidance or recovery <u>any</u> transfer so long as it is 'in connection with' a covered transaction (here a swap) and involves covered participants." (Def's. Br. at 11 (emphasis in original).) Aside from wholly

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parties in light of the potential for rapid changes in the financial markets."); *see also 1989 Hearing* (Statement of Hon. Howell Heflin, Member, Comm. on the Judiciary) ("There is concern that if one of the parties to a swap agreement files for bankruptcy under the current Bankruptcy Code, the nondefaulting party is left with a substantial risk and, depending on the size of the swap agreement, could cause a rippling effect which would undermine the stability of the financial markets.").

[27] Citigroup Global also erroneously concludes that Citigroup Global "performed the precise role the safe harbor was designed to protect" by citing to a provision in a Congressional report explaining the definition of "securities contract," which is irrelevant to the instant Motion. (Def's. Br. at 11.) The Trustee is unaware of any support in Section 546(g)'s legislative history for the proposition that a subsequent transferee, like Citigroup Global, who was party to a swap with a third-party two levels removed from the debtor, should be permitted to invoke the protection of Section 546(g) when the initial transfers are not protected by the safe harbor.

ignoring the plain language of Section 546(g), which expressly limits its scope to precluding avoidance of initial transfers, Citigroup Global cannot point to any legislative authority to support the proposition that this safe harbor was intended to shield subsequent transfers from recovery.

Because no purpose underlying the Section 546(g) safe harbor would be furthered, no justification exists for expanding the plain language of the statute to apply it to the instant recovery action against Citigroup Global.

## III. APPLICATION OF THE SECTION 546(g) SAFE HARBOR HERE IS INAPPROPRIATE

### A. Courts Interpreting Section 546 Safe Harbors Find They Do Not Apply To Fraudulent Schemes

The Section 546 safe harbors were not intended to prevent a trustee from avoiding transfers made by a debtor in furtherance of a Ponzi scheme. Courts have routinely refused to apply the protections of Section 546(e) to transfers made in furtherance of a Ponzi scheme,[28] or

[28] *See Johnson v. Neilson (In re Slatkin)*, 525 F.3d 805, 819 (9th Cir. 2008); *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners)*, 321 B.R. 527, 541 (B.A.P. 9th Cir. 2005) (applying Section 546(e) to payments made in connection with a Ponzi scheme "would amount to an absurd contradiction of the securities laws"); *Wider v. Wooton*, 907 F.2d 570, 573 (5th Cir. 1990) (rejecting application of Section 546(e) defense in a Ponzi scheme context so as not to "implicitly authorize fraudulent business practices through an unjustified extension of the stockbroker defense"); *Picard v. Merkin (In re Bernard L. Madoff Inv. Secs.)*, No. 11 MC 0012 (KMW), 2011 WL 3897970, at *12 (S.D.N.Y. Aug. 31, 2011) (*Merkin II*); *Picard v. Madoff (In re Bernard L. Madoff Inv. Secs.)*, No. 08-01789 (BRL), 2011 WL 4434632, at *15-16 (Bankr. S.D.N.Y. Sept. 22, 2011); *Merkin I,* 440 B.R. at 266-68; *SIPC v. Bernard L. Madoff Inv. Secs. (In re Bernard L. Madoff Inv. Secs.)*, 424 B.R. 122, 137 n. 30 (Bankr. S.D.N.Y. 2010) ("[C]ourts have held that to extend safe harbor protection in the context of a fraudulent securities scheme would be to undermine, not protect or promote investor confidence.") (internal citations omitted); *but see Picard v. Katz, et al. (In re Bernard L. Madoff Inv. Secs.)*, No. 11 Civ. 3605 (JSR), 2011 WL 4448638, at *2-3 (S.D.N.Y. Sept. 27, 2011).

that were otherwise "steeped in fraud"[29] or fraught with "outright illegality." *Geltzer v. Mooney (In re MacMenamin's Grill Ltd.)*, 450 B.R. 414, 428 (Bankr. S.D.N.Y. 2011). The court in *In re MacMenamin's Grill Ltd.* has dubbed this the "illegal conduct exception," reasoning that "Congress never could have meant to permit section 546(e) to protect transactions that themselves were assaults on the securities markets, as that would be a perversion of the statute's purpose." 450 B.R. at 425.

The illegal conduct exception applies with equal force to Section 546(g).[30] Because Madoff's Ponzi scheme was permeated with fraud, even if Section 546(g) were otherwise applicable, the fraudulent transfers made by BLMIS were in furtherance of the Ponzi scheme. As true under Section 546(e), the illegal conduct exception applies and the Section 546(g) safe harbor should have no effect here.

### B. Application Of Section 546(g) Here Is Inconsistent With SIPA

Applying Section 546(g) here is inconsistent with SIPA. SIPA Section 78fff(b) provides that the Bankruptcy Code applies to a SIPA proceeding only to the extent that it is consistent with SIPA. 15 U.S.C. § 78fff(b). SIPA's main purpose is "to reverse losses resulting from brokers' insolvency" and "is intended to expedite the return of customer property." *Picard v.*

[29] *Jackson v. Mishkin, (In re Adler, Coleman Clearing Corp.)*, 263 B.R. 406, 481 (S.D.N.Y. 2001); *In re Grafton Partners,* 321 B.R. at 540.

[30] *Enron Corp. v. Int'l Finance Corp. (In re Enron Corp.),* 341 B.R. 451 (Bankr. S.D.N.Y. 2006); *Enron Corp, v. UBS AG (In re Enron Corp.),* No. 01 B 16034 (AJG), 2005 WL 3873897 (Bankr. S.D.N.Y. Aug. 10, 2005); *Enron Corp. v. Lehman Brothers (In re Enron Corp.)*, No. 01 B 16034 (AJG), 2005 WL 3873896 (Bankr. S.D.N.Y. July 29, 2005); *Enron Corp. v. Credit Suisse First Boston Int'l (In re Enron Corp.),* 328 B.R. 58 (Bankr. S.D.N.Y. 2005) (Group of *In re Enron* cases determining that safe harbor provisions Section 546(e) and (g) do not apply to transactions stemming from null and void underlying settlement payments); *see also In re MacMenamin's Grill*, 450 B.R. at 419 (drawing upon terms defined for Section 546(g) to elaborate definitions for Section 546(e)).

*Maxam Absolute Return Fund, L.P. (In re Bernard L. Madoff Inv. Secs.)*, 460 B.R. 106, 121 (Bankr. S.D.N.Y. 2011) (quoting *In re Bernard L. Madoff Inv. Secs. LLC*, 654 F.3d 229, 239-40 (2d Cir. 2011)); *Hill v. Spencer Savings & Loan Assoc. (In re Bevill, Bresler & Schulman, Inc.)*, 83 B.R. 880, 888 (D.N.J. 1988) ("SIPA provides for pro rata distribution of customer property, including proceeds from avoidance actions, in satisfaction of customer claims."). Accordingly, SIPA vests the Trustee with the power to recover any Customer Property fraudulently transferred by BLMIS to the extent such a transfer is voidable or void under the provisions of the Bankruptcy Code.[31]

A provision of the Bankruptcy Code is not "consistent" with SIPA "if it conflicts with an explicit provision of [SIPA] or if <u>its application</u> would substantially impede the fair and effective operation of SIPA without providing significant countervailing benefits." *SIPC v. Charisma Sec. Corp.*, 506 F.2d 1191, 1195 (2d Cir. 1974) (emphasis added). Thus, in *Merkin I*, the Bankruptcy Court held that applying Section 546(e) in the context of this SIPA proceeding "would eliminate most avoidance powers granted to a trustee under SIPA, negating its remedial purpose." 440 B.R. 243, 267 (Bankr. S.D.N.Y. 2010). The Bankruptcy Court's reasoning in *Merkin I* applies with equal force to Section 546(g) because its application would eviscerate recovery powers granted to a trustee under SIPA. In fact, application of Section 546(g) here would even further "substantially impede" the effective operation of SIPA because, as demonstrated above, the safe harbor does not apply to recovery actions.

[31] *See* 15 U.S.C. § 78fff-2 ("[T]he Trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of [the Bankruptcy Code]."); 15 U.S.C. § 78fff-1(a); 15 U.S.C. § 78fff(b) (a SIPA liquidation proceeding "shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3 and 5 and subchapters I and II of chapter 7 of [the Bankruptcy Code]" to the extent that these provisions are consistent with SIPA).

## IV. CITIGROUP GLOBAL RECEIVED AT LEAST $100 MILLION IN SUBSEQUENT TRANSFERS OF CUSTOMER PROPERTY WITHIN THE TWO YEAR PERIOD EXEMPTED BY SECTION 546(g)

On its face, Section 546(g) does not apply to actual fraudulent transfers under Section 548(a)(1)(A).[32] The Trustee has alleged that BLMIS transferred approximately $1.6 billion of Customer Property to Sentry during the two years prior to the Filing Date (the "Sentry Two Year Initial Transfers") with actual intent to hinder, delay, or defraud as required by Section 548(a)(1)(A). (*See* Compl. at ¶¶ 182, 184.) The Trustee further alleges that approximately $100 million of the Sentry Two Year Initial Transfers was subsequently transferred to Citigroup Global. (*See id.* at ¶ 192.) Accordingly, this $100 million in subsequent transfers of Customer Property made by Sentry to Citigroup Global is exempted from the scope of Section 546(g).[33]

[32] By its express language, Section 548(a)(1)(A) is excepted from the scope of Section 546(g). *See* 11 U.S.C. § 546(g).

[33] To the extent Citigroup Global is suggesting that the Trustee must provide a dollar-for-dollar tracing with regard to the approximately $60 million in subsequent transfers it received in April 2008 (*see* Def's. Br. at 4, n. 4.), such a precise accounting is not required. *See In re Int'l Administrative Servs.*, 408 F.3d at 708 (where debtor "perpetrated a fraud that can only be described as massive . . . [i]t is not fatal to the Trustee's case that dollar for dollar, the exact funds cannot be traced"); *In re Allou Distribs.*, 379 B.R. at 30 ("[I]f dollar-for-dollar accounting is not required at the proof stage, then surely it is not required at the pleading stage either."). Citigroup Global also notes that the Trustee pleads allegations regarding the subsequent transfers at issue "upon information and belief." (*See* Def's. Br. at 4, n. 4.) In this Circuit, however, "allegations may be based on information and belief when facts are peculiarly within the opposing party's knowledge." *Boykin v. Keycorp*, 521 F.3d 202, 215 (2d Cir. 2008). Such is the case here with respect to Citigroup Global, a subsequent transferee that received millions of dollars of Customer Property from BLMIS's massive Ponzi scheme. *See Picard v. Chais, et al. (In re Bernard L. Madoff Inv. Secs.)*, 445 B.R. 206, 236, 236 n. 4 (Bankr. S.D.N.Y. 2011).

## CONCLUSION

For all of the foregoing reasons, Citigroup Global's Motion to Dismiss the Complaint should be denied.

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Respectfully submitted,

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