Exhibit 7

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. KINGATE GLOBAL FUND, LTD., KINGATE EURO FUND, LTD., KINGATE MANAGEMENT, LIMITED, FIM ADVISERS LLP, FIM LIMITED, FEDERICO CERETTI, CARLO GROSSO, CITI HEDGE FUND SERVICES LIMITED, FIRST PENINSULA INDIVIDUALLY AND AS TRUSTEES OF THE ASHBY TRUST, THE ASHBY TRUST, ASHBY INVESTMENT SERVICES LIMITED INDIVIDUALLY AND AS TRUSTEES OF THE ASHBY TRUST, ALPINE TRUSTEES LIMITED INDIVIDUALLY AND AS TRUSTEES OF THE EL PRELA TRUST, PORT OF HERCULES LTD. INDIVIDUALLY AND AS TRUSTEE OF THE EL PRELA TRUST, EL PRELA TRUST, EL PRELA GROUP HOLDING SERVICES, ASHBY HOLDING SERVICES LIMITED, AND EL PRELA TRADING INVESTMENTS LIMITED	Adv. Pro. No. 09-1161 (BRL) Docket No. 1:11-CV-7134 (JSR)

AND HSBC BANK BERMUDA LIMITED,

Defendants.

REPLY MEMORANDUM IN FURTHER SUPPORT OF FIM DEFENDANTS' MOTION TO WITHDRAW THE REFERENCE

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The FIM Defendants[1] respectfully submit this reply memorandum of law in further support of their motion pursuant to 28 U.S.C. § 157(d) to withdraw the reference of this adversary proceeding to the Bankruptcy Court. To avoid unnecessary duplication, the FIM Defendants have not addressed in this memorandum the issues of preemption under SLUSA or the applicability of the safe harbor under section 546(e), and rely instead on their earlier argument (FIM Moving Brief at 10-11) and join and incorporate by reference the arguments at pages 5-12 of the Citi Hedge Reply Memorandum In Support of Motion to Withdraw Reference dated February 24, 2012 (the "Citi Hedge Reply Mem.").

PRELIMINARY STATEMENT

This motion is not, as the Trustee claims, a mechanism for "procedural gamesmanship" or an attempt to "pervert" section 157(d). This proceeding – in which the Trustee seeks to exercise expansive, extra-statutory powers to recover funds beyond his authority and to bring common law claims on behalf of, not the BLMIS estate, but rather thousands of BLMIS customers – requires substantial interpretation of non-bankruptcy federal law.

The arguments advanced by the Trustee and SIPC in opposition to the FIM Defendants' motion to withdraw the reference are not new. In fact, in multiple recent cases where the Trustee has litigated motions to withdraw the reference that are, as to the salient legal issues, indistinguishable from the case here, the Trustee made the very same arguments he makes here and those arguments were rejected. In each of those cases, the District Court held that mandatory withdrawal of the reference is warranted to address the very same issues presented in this proceeding: (1) whether the Trustee has standing under SIPA to assert state common law

[1] Capitalized terms used herein shall have the same meanings ascribed to them in the Memorandum in Support of FIM Defendants' Motion to Withdraw the Reference to the Bankruptcy Court dated October 7, 2011 (the "FIM Moving Brief").

claims on behalf of BLMIS's customers against third parties; (2) whether SLUSA preempts the Trustee's common law claims brought on behalf of those customers; (3) whether the section 546(e) safe harbor applies to the proceeding; (4) whether the Trustee's claims against the FIM Defendants under SIPA and section 550 violate the presumption against extraterritoriality under the Supreme Court's decision in *Morrison*; and (5) whether the Bankruptcy Court lacks authority to decide the adversary proceeding under the Supreme Court's decision in *Stern*.[2]

In light of this Court's numerous holdings withdrawing the reference to the Bankruptcy Court on these very issues, one might expect the Trustee to concede that the motion should be granted rather than wasting the Court's time and resources rehashing these very same issues. Instead, the Trustee disingenuously argues that the same result should not apply here because his claims -- "unlike any of the avoidance actions already before this Court"-- do not implicate section 546(e)'s safe harbor because he is only pursuing claims against the Movants, as subsequent transferees, under section 550. The Trustee misses the point. The same result applies even though the Trustee's claims against the FIM Defendants seek recovery under section 550. To recover from subsequent transferees, the Trustee must first show that the initial transfers to the Funds are avoided, which is impossible because, *inter alia*, the safe harbor provisions of section 546(e) apply to the transfers made from BLMIS to the Funds.[3] On other issues, the Trustee either ignores the Movants' arguments or attempts to vehemently challenge the merits of those arguments. The Trustee's and SIPC's briefs, with extensive discussion of the

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[2] The FIM Defendants also adopt the argument that mandatory withdrawal of the reference is warranted to determine the applicable standard under section 550, as set forth at pages 12-15 of the Citi Hedge Memorandum In Support of Motion to Withdraw Reference dated October 14, 2011 and pages 12-13 of the Citi Hedge Reply Mem.

[3] As noted above, in order to avoid unnecessary duplication, the FIM Defendants do not address this argument in this memorandum and incorporate by reference the argument on this issue in the Citi Hedge Reply Mem. at 8-12.

merits, only highlight the need for substantial interpretation of federal non-bankruptcy law and, thus, mandatory withdrawal of the reference. To the extent that mandatory withdrawal is not granted, permissive withdrawal should be because, given the particular circumstances presented, it would clearly promote the efficient use of judicial resources and the expeditious and economical resolution of this proceeding.

ARGUMENT

I THE PROCEEDING AGAINST THE FIM DEFENDANTS IS SUBJECT TO MANDATORY WITHDRAWAL OF THE REFERENCE

Section 157(d) mandates withdrawal of the reference when a proceeding requires significant interpretation of federal law other than Title 11. 28 U.S.C. § 157(d). Withdrawal of the reference is mandated here because this proceeding will require, *inter alia*, a significant interpretation of SIPA, a federal statute outside of Title 11, and the Bankruptcy Court's authority to hear and decide this proceeding.

A. Withdrawal Is Mandatory Because The Trustee's Claims of Standing Require Substantial Interpretation of SIPA

According to the Trustee, the question of his alleged standing under SIPA to assert claims on behalf of a class of BLMIS customers is not one that requires significant interpretation of non-bankruptcy federal law. *See generally* Trustee Br. at 22-23. The Trustee and SIPC suggest that SIPA is, for all intents and purposes, actually part of the Bankruptcy Code and that, in any event, the issues presented do not require significant interpretation of SIPA. *See* Trustee Br. at 9; SIPC Br. at 14-15. The Trustee and SIPC are wrong, and both this Court and other courts in this District have already rejected these very arguments time and time again. *See, e.g., Picard v. HSBC Bank PLC*, 450 B.R. 406 (S.D.N.Y. 2011) (hereinafter "*HSBC I*") (withdrawing the reference to determine whether the Trustee had standing under SIPA to bring common law claims); *Picard v. JPMorgan Chase*, 454 B.R. 307 (S.D.N.Y. 2011) (same). *See also Picard v.*

Kohn, et al., 11 Civ. 1181, Slip Op. at 2-3 (S.D.N.Y. Feb. 21, 2012); *Picard v. HSBC Bank PLC*, 454 B.R. 25 (S.D.N.Y. 2011) (hereinafter "*HSBC II*") (granting motion to dismiss the Trustee's common law claims and rejecting the Trustee's standing arguments under SIPA).

1. SIPA Is Not a Bankruptcy Statute and Is Not Part of Title 11

SIPA is, on its face, part of Title 15, not Title 11. *HSBC I*, 450 B.R. at 410 ("SIPA expressly provides that it shall be considered an amendment to, and section of the Securities Exchange Act of 1934, and for this reason is codified in Title 15 (where securities laws are placed), rather than in Title 11 (where bankruptcy laws are placed)."); *JPMorgan Chase*, 454 B.R. at 316 (same).[4] Indeed, SIPA expressly states that it shall be considered an amendment to, and section of, the Securities Exchange Act of 1934. 15 U.S.C. § 78bbb; *S.E.C. v. Packer, Wilbur & Co.*, 498 F.2d 978, 985 n.12 (2d Cir. 1974). There should be no dispute that SIPA is federal non-bankruptcy law. Not only has this Court made that clear, but it has also held that a "substantial issue under SIPA is . . . , almost by definition, an issue 'the resolution of [which] requires consideration of both Title 11 and other laws of the United States.'" *HSBC I*, 450 B.R. at 410 (quoting 28 U.S.C. § 157(d)); *JPMorgan Chase*, 454 B.R. at 316.

2. The Trustee's Claims Present Significant Issues That Require Interpretation of SIPA, Not Common Law

Neither the Trustee nor SIPC even address the FIM Defendants' argument that the reference should be withdrawn to determine whether the Trustee has standing under SIPA to assert claims on behalf of BLMIS customers. Instead, the Trustee argues that withdrawal is not mandated because he is merely asserting state common law claims for unjust enrichment, conversion and money had and received. Trustee Br. at 22-23. SIPC, for its part, merely argues

[4] *See also Redington v. Touche Ross & Co.*, 612 F.2d 68, 73 (2d Cir. 1979) (SIPA is "a part" of the securities laws).

that the Trustee has the same powers under SIPA as he does under Title 11, and does not address the question of standing. SIPC Br. at 14-15. These arguments again miss the point. As this Court and the others considering this issue have all uniformly held, whether the Trustee has standing under SIPA to bring his state common law claims on behalf of BLMIS customers is a question of non-bankruptcy federal law that requires substantial interpretation of SIPA, warranting mandatory withdrawal of the reference. *See, e.g., HSBC I*, 450 B.R. 406 (withdrawing the reference to determine whether the Trustee had standing under SIPA to bring common law claims); *JPMorgan Chase*, 454 B.R. 307 (same). *See also Picard v. Kohn*, Slip Op. at 2-3 ("this Court has already held as a matter of law that the Trustee lacks standing to bring common law claims such as those advanced in these three counts [for unjust enrichment, conversion, and money had and received]"); *HSBC II*, 454 B.R. 25 (granting motion to dismiss the Trustee's common law claims and rejecting the Trustee's standing arguments under SIPA).

SIPA sets forth the powers and rights of both SIPC and the Trustee, but nowhere does the statute grant standing to bring claims on behalf of customers against third parties. *See* 15 U.S.C. §§ 78fff-3(a), 78fff-2(b). Indeed, this Court has held that neither Title 11 nor SIPA confer standing on a bankruptcy trustee to assert common law claims against third parties on behalf of the estate's creditors themselves, because the trustee stands in the shoes of the debtor, not the creditors. *HSBC II*, 454 B.R. at 37 ("the Trustee does not have standing to bring his common law claims either on behalf of customers directly or as bailee of customer property, enforcer of SIPC's subrogation rights, or assignee of customer claims"). Moreover, the Trustee cannot bring his common law claims on behalf of the estate itself because of the doctrine of *in pari delicto*.

Id. at 37.[5]

Neither the Trustee nor SIPC have set forth any basis for the Trustee's standing to assert these common law claims in their opposition papers.[6] If the Court determines that they did not already concede that the Trustee lacks standing by failing to oppose the FIM Defendants' argument on this point, consideration of the issue involves substantial interpretation of non-bankruptcy law and thus requires mandatory withdrawal of the reference.

B. Whether SIPA Applies Extraterritorially Requires Significant Interpretation of the Reach of the Statute in the Wake of *Morrison*

As explained in FIM's Moving Brief and below, the Trustee seeks to apply SIPA extraterritorially to recover funds paid by one foreign entity to other foreign entities entirely outside the United States. Given the sheer novelty of *Morrison*, and the complexities Article III courts have faced in applying its newly-articulated extraterritoriality principles, it is stunning that the Trustee asserts that the issue of whether his SIPA claims exceed their permissible territorial limits will require nothing more than a simple application of *Morrison*. The FIM Defendants do not, as the Trustee contends, seek to have this Court withdraw the reference to simply "apply" *Morrison.* The FIM Defendants seek mandatory withdrawal of the reference so that an Article III court can determine the substantial issue of whether the Trustee's SIPA claims against the FIM Defendants are barred because they are extraterritorial.

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[5] As this Court has already found, although the *in pari delicto* doctrine is an affirmative defense under New York law, standing in a federal court is controlled by federal law. The *Wagoner* rule bars the Trustee, as "successor in interest" to Madoff and Madoff Securities, from bringing common law claims. Thus, the Trustee has no standing to pursue on behalf of the BLMIS estate his common law claims against the FIM Defendants. *Id.*

[6] By failing to oppose the argument, the Trustee and SIPC have waived opposition on this point, and the Motion should be granted on this basis alone. *See In re AOL Time Warner, Inc. Sec. and "ERISA" Litig.*, No. 02 Civ. 8853 (SWK), 2005 WL 563166, at *5 (S.D.N.Y. Mar. 10, 2005) ("In its opposition papers, plaintiffs ignore the argument, apparently conceding the point.").

Although the Trustee argues that there is "no apparent reason" why he cannot seek to apply SIPA extraterritorially, this is clearly an unsettled issue in light of *Morrison,* and the interpretation of this statute must be made by an Article III court. As this Court is aware, in *Morrison*, the Supreme Court reasserted the presumption *against* the extraterritorial application of U.S. statutory law. Even before *Morrison*, courts in this District had found that the bankruptcy sections upon which the Trustee relies here did not have extraterritorial reach. *See, e.g., In re Maxwell Commc'n Corp.*, 186 B.R. 807, 818 (S.D.N.Y. 1995) (pre-*Morrison*, holding that presumption against extraterritoriality prevented application of § 547 of the Bankruptcy Code to foreign transfers).

The Trustee offers nothing to overcome the presumption against extraterritorially. Leaving aside a decision on personal jurisdiction and pre-*Morrison* law, the Trustee merely points to language in 11 U.S.C. § 541 (and 28 U.S.C. § 1334(e)(1)), which provides that the "estate is comprised of all of [certain] property, wherever located and by whomever held. . ." and cases that address what constitutes property of the estate. Trustee's Br. at 17-18. However, section 541 by its terms only applies to property which is property of the estate. Because preferential and fraudulent transfers do not become property of the estate until recovered, *see In re Colonial Realty Co.*, 980 F.2d 125, 131 (2d Cir. 1992), section 541 does nothing to suggest that Congress intended section 550 to extend to extraterritorial transfers. *See also In re Maxwell Commc'n Corp.*, 186 B.R. at 820.

The Trustee also attempts to minimize the extraterritorial nature of the claims he asserts against the FIM Defendants (arguing that the supposedly fraudulent transactions took place in New York and that the only extraterritorial aspect is that "Movants are incorporated outside the United States"), but the Complaint makes clear that his claims against the FIM Defendants hinge

on whether or not he can apply SIPA extraterritorially. The Trustee is seeking to extend section 550 of the Bankruptcy Code to recover fees paid by one foreign entity to another foreign entity entirely outside the United States pursuant to a foreign contract.[7] *Morrison* may not be circumvented by the Trustee's focus on the initial transfers from BLMIS to the Funds, which are removed from the supposed subsequent transfers he seeks to avoid – subsequent transfers that occurred entirely outside of the United States between foreign entities. As the Supreme Court recognized, "it is a rare case of prohibited extraterritorial application that lacks all contact with the territory of the United States." *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869, 2884 (2010). "[T]he presumption against extraterritorial application," the Court added, "would be a craven watchdog indeed if it retreated to its kennel whenever some domestic activity is involved in the case." *Id.* Despite the fact that some of the funds may have originated with BLMIS, the alleged subsequent transfers to the FIM Defendants were entirely extraterritorial.

Article III courts only now are beginning to examine the interplay between *Morrison*, SIPA and the bankruptcy laws, and the law clearly is not settled. Although the Trustee argues the merits of the FIM Defendants' arguments, this only underscores the need to have an Article III court decide this substantial issue involving the reach of a federal, non-bankruptcy statute. Indeed, this Court has already reached that very conclusion in analogous circumstances, and the same result should apply in this case. *See Picard v. Kohn*, 11-CV-1181 (JSR) (June 3, 2011)

[7] The Complaint itself alleges that Messrs. Grosso and Ceretti, both Italian citizens residing in the United Kingdom, and FIM Limited and FIM Advisers, both incorporated under the laws of the United Kingdom, received certain fees pursuant to a foreign contract, either directly or indirectly, from KML, a corporation organized under the laws of Bermuda, which in turn had received unspecified management fees from foreign investors in the Kingate Funds, both organized under the laws of the British Virgin Islands. Compl. ¶¶ 19, 21, 49, 50, 57, 61, 65, 68, 70.

(withdrawing the reference to determine whether the Trustee's RICO claims "are otherwise barred because those claims are extraterritorial in nature" in light of *Morrison*).

C. WITHDRAWAL OF THE REFERENCE IS REQUIRED FOR THE DISTRICT COURT TO CONSIDER WHETHER THE BANKRUPTCY COURT HAS THE CONSTITUTIONAL OR STATUTORY AUTHORITY TO HEAR AND DETERMINE THIS ADVERSARY PROCEEDING

In *Stern v. Marshall*, 131 S. Ct. 2594 (2011), the Supreme Court held that the counterclaim was "a state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor's proof of claim in bankruptcy." *Id.* at 2611. It held that only an Article III judge could issue a final judgment on the counterclaim despite the fact that the litigation was part of a "core" proceeding and the plaintiff had submitted to the bankruptcy court's jurisdiction. *Id.* at *2608, 2615, 2617-18.

Although the Trustee tries to minimize the impact of *Stern* (or mischaracterize the question as one of jurisdiction, despite clear indication otherwise by the Supreme Court), the courts that have considered the issue since the filing of this motion confirm that, at best, it is unclear whether bankruptcy courts possess the Constitutional authority to hear and determine fraudulent conveyance claims and state law claims such as those brought against the FIM Defendants. And, as other courts have held, bankruptcy courts lack that authority. As such, withdrawal of the reference is required for this Court to determine that issue.[8]

In *Stern*, the Supreme Court made clear that fraudulent conveyance claims like the one asserted here may not be heard and determined by a non-Article III bankruptcy court, even though 28 U.S.C. § 157(b)(2)(H) designates as core proceedings "proceedings to determine,

[8] There is no doubt that resolving Constitutional questions mandates withdrawal. *See In re Avtex Fibers-Front Royal, Inc.*, No. 90-0510, 1991 WL 25460, at *2 (E.D. Pa. Feb. 26, 1991) ("The ultimate non-Code law is the United States Constitution, and consideration of that law mandates withdrawal.").

avoid, or recover fraudulent conveyances." Discussing its 1989 decision in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 31 (1989), the Court found that fraudulent conveyance actions were "'quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res.'" *Stern*, 131 S.Ct. at 2614 (quoting *Granfinanciera*, 492 U.S. at 56). The *Stern* Court used the unequivocally "private right" characteristics of the fraudulent conveyance claim in *Granfinanciera* to underscore why the state law counterclaim in *Stern* could not be heard and determined by the bankruptcy court, a non-Article III court.

As in *Granfinanciera*, none of the FIM Defendants filed a proof of claim seeking affirmative recovery from the BLMIS estate. Accordingly, the fraudulent conveyance claims do not arise "as part of the process of allowance and disallowance of claims," and are not "integral to the restructuring of debtor-creditor relations." *Granfinanciera*, 492 U.S. at 58. Moreover, the Trustee's claim against the FIM Defendants seeks fees received by private parties pursuant to a contract with other private parties. Compl. at ¶¶ 123, 124. It is therefore analogous to the "private right" characteristics of the fraudulent conveyance claim in *Granfinanciera* on which the Supreme Court based its finding.

The decisions on this issue are not, as the Trustee suggests, one-sided. *See Picard v. Flinn*, 11-cv-5223, Slip Op. at 10-14 (S.D.N.Y. Nov. 29, 2011) (withdrawing the reference to determine bankruptcy court's authority after *Stern*). To the contrary, the law on this issue is entirely unsettled.[9] *See In re Teleservices Group, Inc.*, No. 07-80037, 2011 WL 3610050, at

[9] "Since its release, a maelstrom of opinions and articles have been written about the scope of *Stern*, ranging from 'much ado about nothing' to 'the end of the bankruptcy world as we know
[Footnote continued on next page]

*14 (Bankr. W.D. Mich. Aug. 17, 2011) (no authority to hear fraudulent transfer action pursuant to section 550 of the Bankruptcy Code); *In re Sitka Enters.,* No. 10-1847, 2011 U.S. Dist. LEXIS 90243, at *7 (D.P.R. Aug. 12, 2011) (finding that the fraudulent conveyance action brought by the trustee under sections 548 and 549 "cannot be adjudicated by the Bankruptcy Court, a non-Article III court, for lack of constitutional authority to do so"). *See also In re Fairfield Sentry Ltd.*, --- B.R. ---, No. 11 MC 224 (LAP), 2011 U.S. Dist. LEXIS 106275 (S.D.N.Y. Sept. 19, 2011) (district court reversed and remanded bankruptcy court's denial of mandatory abstention); *Retired Partners of Coudert Bros. Trust v. Baker McKenzie LLP (In re Coudert Bros. LLP)*, App. Case No. 11–2785 (CM), 2011 U.S. Dist. LEXIS 110425 (S.D.N.Y. Sept. 23, 2011) (district court vacated bankruptcy court rulings on "related to" state law claims and converted the rulings to a report and recommendation; whether a bankruptcy court can finally adjudicate a matter post-*Stern* depends on whether the claim to be adjudicated involves a "public" or "private" right).

Although this District recently amended its standing order on reference to provide that a bankruptcy court can, unless otherwise ordered by a district court, hear proceedings and submit proposed findings of fact and conclusions of law to the District Court where the entry of a final order by a bankruptcy judge is not consistent with Article III, it is not clear that the Bankruptcy Court even has statutory authority under 28 U.S.C. § 157 to propose findings of fact or conclusions of law with respect to fraudulent transfer claims. Under 28 U.S.C. §157(b)(2)(H), Congress expressly designated actions seeking recovery of "fraudulent conveyances" as "core" proceedings. There is no statutory authority to treat these "core" proceedings as "non-core" proceedings under 28 U.S.C. §157(c) and have the Bankruptcy Court submit proposed findings

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[Footnote continued from previous page]
it.'" *BankUnited Fin. Corp. v. Fed. Dep. Ins. Corp. (In re BankUnited Fin. Corp.)*, Adv. No. 10-02872-BKC-LMI, 2011 Bankr LEXIS 4531, at *13 (Bankr. S.D. Fla. Nov. 22, 2011).

of facts or conclusions of law. *See In re Blixseth*, No. 09-60452-7, 2011 Bankr. LEXIS 2953, at *34-35 (Bankr. D. Mont. Aug. 1, 2011), *amended on other grounds*, 2012 Bankr. LEXIS 19 (Jan. 3, 2012) ("Unlike in non-core proceedings, a bankruptcy court has no statutory authority to render findings of fact and conclusions of law for core proceedings that it may not constitutionally hear."). Moreover, this does not address the Bankruptcy Court's authority to adjudicate the state common law claims brought by the Trustee. Therefore, withdrawal of the reference is necessary so that the District Court may determine the Bankruptcy Court's authority in light of *Stern*.[10]

D. The Trustee and SIPC should be estopped from arguing that mandatory withdrawal of the reference is not required

"Under New York law, collateral estoppel bars re-litigation of an issue when (1) the identical issue necessarily was decided in the prior action and is decisive of the present action, and (2) the party to be precluded from relitigating the issue had a full and fair opportunity to litigate the issue in the prior action." *Evans v. Ottimo*, 469 F.3d 278, 281 (2d Cir. 2006). There is no requirement that "the parties against whom plaintiffs litigated in the prior proceeding be the same parties they litigate against in the current proceeding." *Reyes v. Fairfield Props.*, 661 F. Supp. 2d 249, 276 (E.D.N.Y. 2009). In their Oppositions, the Trustee and SIPC have raised the very same arguments against mandatory withdrawal of the reference that they raised in prior proceedings and have repeatedly lost on the grounds of: (1) standing under SIPA to assert claims on behalf of BLMIS customers; (2) the safe harbor defense under section 546(e); and (3) preemption under SLUSA. The Trustee and SIPC should be estopped from making the same

[10] Moreover, even if the Bankruptcy Court could submit proposed findings of fact and conclusions of law, the District Court would be required to review those *de novo*, adding an unnecessary administrative burden and expense to these proceedings and justifying withdrawal of the reference for cause. *See infra* at 18.

arguments against withdrawal of the reference that have been rejected by this Court and others time and time again.

II THE CAUSE FOR PERMISSIVE WITHDRAWAL IS SUBSTANTIAL[11]

Even if the Court were to find that withdrawal of the reference is not mandatory, substantial cause exists for permissive withdrawal of the reference.

A. The Claims Against the FIM Defendants Are Predominantly Non-Core

1. The District Court Should Make the Core/Non-Core Determination

As the Trustee concedes, under the Second Circuit's decision in *Orion*, "[a] district court considering whether to withdraw the reference should first evaluate whether the claim is core or non-core." *In re Orion Pictures Corp.*, 4 F.3d 1095, 1101 (2d Cir. 1993) (listing other relevant factors to be considered "once a district court makes the core/non-core determination"); *see also In re The VWE Group. Inc.*, 359 B.R. 441, 448 (S.D.N.Y. 2007) (collecting cases) ("courts of this circuit have held repeatedly that district courts may determine the nature of the proceeding in the first instance."). Here, the non-core claims asserted against the FIM Defendants dominate this proceeding.

2. Non-Core Claims Dominate the Proceeding Against the FIM Defendants

While the Trustee attempts to focus on the one claim he has asserted under the Bankruptcy Code against the FIM Defendants, his state common law claims against the FIM Defendants predominate. In fact, out of the fifteen claims in the Complaint, there are only four

[11] In the FIM Moving Brief, the FIM Defendants briefly argued that permissive withdrawal of the reference was warranted if mandatory withdrawal were not granted, and reserved the right to fully brief that issue. *See* FIM Moving Brief at 8-9. Because the Trustee and SIPC challenge both mandatory withdrawal and permissive withdrawal in their oppositions, the FIM Defendants are responding to those arguments regarding permissive withdrawal. Of course, if the Court grants the motion on the basis of mandatory withdrawal, it need not reach this issue.

claims asserted against the FIM Defendants, three of which are common law claims for unjust enrichment, conversion, and money had and received. Moreover, the Trustee appears to be seeking greater damages with respect to each of his common law claims than the undefined damages he seeks to recover under section 550.[12] Contrary to the Trustee's assertions, these state law claims are not core, nor are they "inextricably tied" to his bankruptcy claim. Even the section 550 claim, to the extent it is based on New York State Debtor Creditor Law, is non-core. *See Stern*, 131 S. Ct. at 2614 (fraudulent conveyance actions are "quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchical ordered claims to a pro rata share of the bankruptcy res … [and thus are] 'more accurately characterized as a private rather than a public right.'").

3. The Common Law Claims Are Non-Core

Plaintiffs cannot obscure the obvious fact that the Trustee's common law claims are fundamentally non-core, owing their existence entirely to state law. *See In re Adelphia*, No. 03-MDL-1529, 2006 WL 337667, at *4 (S.D.N.Y. Feb. 10, 2006) (finding state law tort claims such as aiding and abetting breach of fiduciary duty are non-core); *Everett v. MCI, Inc. (In re WorldCom, Inc.)*, No. 07 Civ. 9590, 2008 WL 2441062, at *4 (S.D.N.Y. June 18, 2008) (claim

[12] The Trustee alleges that the FIM Defendants are liable under state common law for undefined damages of "all proceeds of the illegal scheme" (Compl. ¶ 350), "billions of dollars [investors] personally invested with BLMIS" (Compl. ¶ 351), and "these monies" (Compl. ¶ 356) along with punitive damages (Compl. at 82, ¶ xiv). In contrast, the section 550 claim seeks to recover limited fees that the FIM Defendants earned from the Kingate Funds consisting of "some or all of the [initial] Transfers" (Compl. ¶ 334), which the Trustee estimates, at best, as "millions of dollars" undifferentiated between defendants. *See, e.g.*, Compl. ¶¶ 19, 21, 55, 131-139. Moreover, because the Trustee is limited to the two-year statutory period because of the Section 546(e) safe harbor, the potential recovery under his common law claims, which have longer limitations periods, is clearly greater. *See Picard v. Katz, et al.*, 462 B.R. 447 (S.D.N.Y. 2011)

for unjust enrichment is non-core because it has "little relation to the Bankruptcy Code, do[es] not arise under federal bankruptcy law, and would exist in the absence of a bankruptcy case"); *Appel v. Mainstar Oil Co. (In re B & L Oil Co.)*, 46 B.R. 731, 736 (Bankr. D. Colo. 1985) (claim for money had and received is non-core); *Hassett v. BancOhio Nat'l Bank (In re CIS Corp.)*, 172 B.R. 748, 758 (S.D.N.Y. 1994) ("Claims asserting the unlawful conversion of property unquestionably arise under state law and are considered non-core proceedings"); *In re Jamuna Real Estate*, LLC, 357 B.R. 324, 332 (Bankr. E.D. Pa. 2006) (conversion claim is non-core; noting that "the weight of authority" supported this holding).

The Trustee nevertheless claims that these non-core claims are "core" because they "affect the bankruptcy estate" and are "inextricably linked with" and could not have been brought "if not for the subsequent transfers made avoidable" under bankruptcy law. Trustee's Br. at 24-25. [13] These arguments fail. First, the Trustee argues, without any basis whatsoever, that all claims are core if they "seek to impose a remedy to recover certain transfers of Customer Property for the benefit of [the estate]." Trustee's Br. at 25. This argument proves too much. Taken to its logical conclusion, any claim that could potentially afford recovery to the estate would be core. This was clearly not Congress's intent.

Second, the Trustee argues that the claims are "inextricably tied" because they could not have been brought if not for the subsequent transfer claims. However, the Trustee's state law claims exist entirely independently of any clawback claim he may have. In fact, plaintiffs in an action brought in this very court attempted to assert similar state law claims against certain of the FIM Defendants and others, seeking the same recovery (i.e., fees paid to the FIM Defendants)

[13] SIPC does not address this issue, relying instead on a mere conclusory statement that the permissive withdrawal standard is not met. SIPB Br. at 6.

based on similar allegations that the FIM Defendants ignored "red flags," and those plaintiffs asserted those claims independently of any bankruptcy claims. *See In re Kingate Management Ltd Litig.*, 1:09-cv-05386-DAB (S.D.N.Y.) (alleging state law claims for unjust enrichment, fraud, misrepresentation, negligence, breach of contract, and breach of fiduciary duty). The Trustee himself brought an action against the FIM Defendants in the United Kingdom asserting similar non-core claims and seeking the same recovery, independent of any bankruptcy claims. *See* Kleinick Reply Declaration, Exhibit 1. Not only do his state law claims stand separately from his section 550 claim, but, as explained above, whether SIPA even allows the Trustee to, in effect, pursue state common law claims belonging to investors is an unsettled question that further supports withdrawal of the reference.[14]

B. The Remaining *Orion* Factors Support Withdrawal

1. Withdrawal Would Promote Efficiency

Even if all of the Trustee's claims against the FIM Defendants were core claims – which they are not – withdrawal would still be warranted because, "[i]n the final analysis, the critical question is efficiency and uniformity." *Mishkin v. Ageloff*, 220 B.R. 784, 800 (S.D.N.Y. 1998). Here, these interests are best served by litigating all of the issues raised in this Motion in the District Court, where these very same issues are being decided in other proceedings, thereby avoiding the risk of inconsistent rulings. These issues, while having a substantial impact on the

[14] None of the cases on which the Trustee relies to support his assertion even remotely suggest that these state law claims can be considered "core." Two of the three cases do not even address whether the claims at issue are core or non-core, or whether withdrawal of the reference was appropriate. *See In re Kaiser*, 722 F.2d 1574, 1580 (2d Cir. 1983) (not requiring the court to decide whether certain common law claims were core or non-core); *In re Builders Capital and Services, Inc.*, 317 B.R. 603, 609 (Bankr. W.D.N.Y. 2004) (same). The third merely stands for the proposition that state law claims can be considered core if they are based on the same transaction as a creditor's proof of claim. *In re Neumann Homes, Inc.*, 414 B.R. 383, 388 (N.D. Ill. 2009). Here, the FIM Defendants filed no proof of claim.

viability of the Trustee's claims against the FIM Defendants, are relatively limited, are clearly within the jurisdiction of this Court to determine, and that determination requires no special expertise with the BLMIS liquidation or the thousands of customer claims asserted in the SIPA case.

Moreover, the Trustee's arguments suggesting that the Bankruptcy Court has some meaningful connection to this proceeding are disingenuous. First, given the filing of this Motion at the outset of the proceeding against the FIM Defendants, there have been no proceedings before the Bankruptcy Court with respect to the claims against them. Second, while the Trustee and SIPC point to the sheer volume and length of the SIPA bankruptcy proceedings filed by the Trustee relating to BLMIS, the overwhelming majority of those cases involve garden variety bankruptcy claims to avoid transfers of fictitious profits made to BLMIS customers (which do not raise substantial issues of standing under the securities laws, SLUSA preemption or the extraterritorial effect of SIPA). Third, even the Trustee's proceedings against other feeder funds do not involve the same group of defendants or underlying conduct. Moreover, in the handful of proceedings that do raise the issues raised in this Motion, the Court has consistently concluded that the reference should be withdrawn. *See, e.g., J.P. Morgan Chase*, 454 B.R. 307; *Kohn*, 11 Civ. 1181 (S.D.N.Y.); *HSBC I*, 450 B.R. 406; *Flinn*, 11-cv-5223.[15]

[15] The Court's decision in *Mishkin* is instructive. There, the SIPC trustee opposed withdrawal of two core actions on the grounds that they were "related to other proceedings before the bankruptcy court in which the parties have not sought withdrawal," to which the bankruptcy judge had "devoted a considerable amount of time . . . holding countless hearings and issuing an equally large number of orders." *Mishkin*, 220 B.R. at 800. Nevertheless, the Court withdrew the reference because the two actions were "most related" to a third action subject to mandatory withdrawal. *Id.* The Court held that "to leave [the actions] before the bankruptcy court would, on balance, result in greater inefficiency than withdrawing them here, in spite of whatever related actions may continue before the bankruptcy court." *Id.* The same result is warranted here, because this action is far more similar to the other actions before the District Court.

Further, as explained above, in light of *Stern*, there is a substantial question about whether the Bankruptcy Court lacks constitutional and statutory authority to hear and determine the claims asserted against the FIM Defendants, including for pre-trial matters, making this Court the only appropriate court to determine these claims. Indeed, even if the Bankruptcy Court had statutory authority to hear the claims, the Bankruptcy Court could at most submit proposed findings of fact and conclusions of law, which the District Court would be required to review *de novo*, adding an unnecessary administrative burden and expense to these proceedings. *See OCUC v. Amlicke (In re VWE Group, Inc.*), 359 B.R. 441, 451 (S.D.N.Y. 2007) (where the determination of the claim "would be subject to de novo review in the district court, unnecessary costs can be avoided by a single proceeding in this [district] court."). Moreover, not all of the defendants filed claim forms and those that did not would be entitled to a jury trial in the District Court in the event that they do not consent to a trial in the Bankruptcy Court. [16] 28 U.S.C. §157(d) & (E). Unless the reference is withdrawn now, the parties will likely be forced to litigate these claims twice – once in the Bankruptcy Court and then again in the District Court. Withdrawing the reference now will avoid imposing this unnecessary burden on the parties and this Court.

2. The Bankruptcy Court Does Not Possess Knowledge of Any Particular Facts Sufficient to Outweigh Efficiency Concerns

The Bankruptcy Court has no knowledge of any particular facts that would justify having it decide the issues presented in this Motion. This proceeding is still in its infancy.[17] As noted

[16] The FIM Defendants did not file any claim and reserve all rights to request a jury trial.

[17] The Trustee originally filed this case in April 2009 against only three of the current Defendants (and not against any of the FIM Defendants), alleging avoidance and turnover claims. Adv. No. 09-1161, Dkt. No. 1. The Trustee then filed two slightly longer but substantively similar complaints in May 2009 and July 2009, and the parties agreed to a dozen
[Footnote continued on next page]

above, promptly after the Third Amended Complaint was filed, naming the FIM Defendants for the first time, the FIM Defendants filed this Motion. None of the Defendants have even responded to the Complaint, and their time to do so has been extended by stipulation until June 2012. Adv. No. 09-1161, Dkt. No. 78. The Bankruptcy Court has not yet held a single conference, no discovery has taken place in that court, and no issues have been presented to that court for determination. As a result, the Bankruptcy Court is not more familiar with the Trustee's allegations, the bulk of which concern securities fraud-style "red flag" allegations and common law claims beyond the Bankruptcy Court's specialized expertise and authority to determine.

In contrast, this Court is uniquely positioned to decide the issues raised by this motion as it already possesses a distinct familiarity with Madoff-related litigation. This Court has already withdrawn the reference in numerous actions that raise issues identical or similar to those raised by this Motion. In addition, this Court will have to decide the same or similar complex issues of law in the numerous Madoff-related cases in which the reference has been withdrawn. Withdrawing the reference will also prevent the danger of inconsistent decisions. Accordingly, considerations of efficiency compel permissive withdrawal of the reference.

3. This Case Presents No Forum-Shopping Concerns on the Part of the FIM Defendants

The fact that the Trustee has the audacity to accuse the FIM Defendants of forum shopping is nothing short of ironic. The Trustee is blatantly attempting to engage in forum

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[Footnote continued from previous page]
adjournments. Adv. No. 09-1161, Dkt. Nos. 5-31. After that, nothing happened in the action until June 8, 2011, when the Trustee filed his Third Amended Complaint joining 15 new defendants, including the FIM Defendants, and asserting his state common law claims for the first time. Adv. No. 09-1161, Dkt. No. 32.

shopping with respect to the FIM Defendants by even naming the FIM Defendants in this proceeding. The Trustee initially brought proceedings in the United Kingdom against the FIM Defendants to obtain pre-action discovery. After litigating that issue in the U.K. courts for almost two years, the Trustee brought an action against the FIM Defendants in the U.K. in December 2010, asserting almost identical claims based on the same allegations as he asserts here. Kleinick Reply Decl., Exhibit 1. Seven months later, the Trustee filed the Third Amended Complaint here and asserted almost identical claims against the FIM Defendants in the Bankruptcy Court, apparently attempting to hedge his bets as to which forum he preferred. The Trustee has been unwilling thus far to voluntarily dismiss his claims in either jurisdiction.[18]

In any event, there is no forum shopping motive by the FIM Defendants. By seeking withdrawal of the reference, the FIM Defendants are not seeking the benefit of more favorable laws or geographical convenience. *See Adelphia*, 2006 WL 337667 at *5 (finding no forum shopping motive because "both the bankruptcy court and the district court [are] bound to follow Second Circuit law, and both courts [are] located in downtown Manhattan"). Rather, they simply seek to have important issues of non-bankruptcy federal law decided by a District Court, as they are entitled to do.

CONCLUSION

For the foregoing reasons, this Court should withdraw the reference to the Bankruptcy Court under 28 U.S.C. § 157(d), and this proceeding should be heard in the District Court.

[18] The FIM Defendants intend to raise this issue at the appropriate stage of this proceeding.

Dated: New York, New York
February 24, 2012

By: /s/ Jodi Kleinick

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