UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES INVESTOR PROTECTION CORPORATION, Plaintiff-Applicant, v. BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Defendant.	SIPA LIQUIDATION No. 08-01789 (BRL) Substantively Consolidated
In re: BERNARD L. MADOFF, Debtor.	
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. UBS AG, UBS (LUXEMBOURG) SA, UBS FUND SERVICES (LUXEMBOURG) SA, UBS THIRD PARTY MANAGEMENT COMPANY SA, ACCESS INTERNATIONAL ADVISORS LLC, ACCESS INTERNATIONAL ADVISORS EUROPE LIMITED, ACCESS INTERNATIONAL ADVISORS LTD., ACCESS PARTNERS (SUISSE) SA, ACCESS MANAGEMENT LUXEMBOURG SA (f/k/a ACCESS INTERNATIONAL ADVISORS (LUXEMBOURG) SA) as represented by its Liquidator MAITRE FERNAND ENTRINGER, ACCESS PARTNERS SA as represented by its Liquidator MAITRE FERNAND ENTRINGER, PATRICK LITTAYE, CLAUDINE MAGON DE LA VILLEHUCHET (a/k/a CLAUDINE DE LA VILLEHUCHET) in her capacity as Executrix under the Will of THIERRY MAGON DE LA VILLEHUCHET (a/k/a RENE THIERRY DE LA VILLEHUCHET), CLAUDINE MAGON DE LA VILLEHUCHET (a/k/a CLAUDINE DE LA	Adv. Pro. No. 10-04285 (BRL) Case No. 1:11-cv-4212 (CM)

VILLEHUCHET) individually as the sole beneficiary under the Will of THIERRY MAGON DE LA VILLEHUCHET (a/k/a RENE THIERRY DE LA VILLEHUCHET), PIERRE DELANDMETER, THEODORE DUMBAULD, LUXALPHA SICAV as represented by its Liquidators MAITRE ALAIN RUKAVINA and PAUL LAPLUME, MAITRE ALAIN RUKAVINA AND PAUL LAPLUME, in their capacities as liquidators and representatives of LUXALPHA SICAV, ROGER HARTMANN, RALF SCHROETER, RENE EGGER, ALAIN HONDEQUIN, HERMANN KRANZ, BERND (a/k/a, BERNARD) STIEHL, GROUPEMENT FINANCIER LTD.,

Defendants.

IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC,

Third-Party Plaintiff,

v.

UBS AG, UBS (LUXEMBOURG) SA, UBS FUND SERVICES (LUXEMBOURG) SA, UBS THIRD PARTY MANAGEMENT COMPANY SA, ACCESS INTERNATIONAL ADVISORS LLC, ACCESS INTERNATIONAL ADVISORS EUROPE LIMITED, ACCESS INTERNATIONAL ADVISORS LTD., ACCESS PARTNERS (SUISSE) SA, ACCESS MANAGEMENT LUXEMBOURG SA (f/k/a ACCESS INTERNATIONAL ADVISORS (LUXEMBOURG) SA) as represented by its Liquidator MAITRE FERNAND ENTRINGER, ACCESS PARTNERS SA as represented by its Liquidator MAITRE FERNAND ENTRINGER, PATRICK LITTAYE, CLAUDINE MAGON DE LA VILLEHUCHET (a/k/a CLAUDINE DE LA VILLEHUCHET) in her capacity as Executrix under the Will of THIERRY MAGON DE LA VILLEHUCHET (a/k/a RENE THIERRY DE LA VILLEHUCHET), CLAUDINE MAGON DE LA VILLEHUCHET (a/k/a CLAUDINE DE LA VILLEHUCHET) individually as the sole beneficiary under the Will of THIERRY MAGON DE LA VILLEHUCHET (a/k/a RENE THIERRY DE LA VILLEHUCHET), PIERRE DELANDMETER, THEODORE DUMBAULD, LUXALPHA SICAV as represented by its Liquidators MAITRE ALAIN RUKAVINA and PAUL LAPLUME, MAITRE ALAIN RUKAVINA AND PAUL LAPLUME, in their capacities as liquidators and representatives of LUXALPHA SICAV, ROGER HARTMANN, RALF SCHROETER, RENE EGGER, ALAIN HONDEQUIN, HERMANN KRANZ, BERND (a/k/a, BERNARD) STIEHL, GROUPEMENT FINANCIER LTD.,

Third-Party Defendants.

TRUSTEE'S MEMORANDUM OF LAW IN OPPOSITION TO MOTION TO DISMISS

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Irving H. Picard, as trustee ("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, individually, by and through his undersigned counsel, respectfully submits this memorandum of law in opposition to the motions to dismiss of the UBS Defendants and the Luxalpha Director Defendants, and the related joinders of Access International Advisors LLC, Access International Advisors Europe Limited, Access International Advisors Ltd., Access Partners (Suisse) SA, Access Management Luxembourg SA, Access Partners SA, Patrick Littaye, Claudine Magon de la Villehuchet, Pierre Delandmeter, Groupement Financier Ltd. ("Groupement")[1] and Theodore Dumbauld (collectively, the "Moving Defendants").[2]

PRELIMINARY STATEMENT

Through their motions and joinders to JPMorgan's motion to dismiss in another Madoff case, *Picard v. JPMorgan Chase & Co., et al.,* No. 1:11-cv-00913 (CM) (MHD), the Moving Defendants seek to evade accountability for their knowing participation in Madoff's fraud. This is but the latest step in that endeavor, as from the start, the Moving Defendants have sought to enable and profit from Madoff's fraud while escaping liability.

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[1] While Defendant Groupement purports to join in the motion to dismiss, such joinder is inappropriate given that the motion to dismiss addresses only the Trustee's common law claims, while the Trustee has asserted only preference and avoidance claims against Groupement.

[2] For purposes of this opposition, and consistent with the Trustee's Amended Complaint, the UBS Defendants are defined to include UBS AG, UBS (Luxembourg) SA, UBS Fund Services (Luxembourg) SA and UBS Third Party Management Company SA. On this motion, the Luxalpha Director Defendants include Rene Egger, Alain Hondequin, Hermann Kranz and Ralf Schroeter only. The Access Defendants are defined to include Access International Advisors LLC, Access International Advisors Europe Limited, Access International Advisors Ltd., Access Partners (Suisse) SA, Access Management Luxembourg SA, Access Partners SA, Patrick Littaye, Claudine Magon de la Villehuchet in both her capacities as Executrix under and as sole beneficiary of the Will of Thierry Magon de la Villehuchet, Pierre Delandmeter and Theodore Dumbauld. At this time, none of the Access Defendants (all of whom are foreign), with the exception of Ms. de la Villehuchet, has agreed to permit their counsel to accept service of the Amended Complaint. Accordingly, these Defendants should not be able to join in the instant Motion, which is directed at the Amended Complaint.

The UBS Defendants began their relationship with Madoff fully aware of the likelihood that he was a fraud and fully willing to accommodate his fraud in order to profit from it. While providing their prestigious name to serve as a façade of legitimacy for the Luxalpha and Groupement feeder funds, they delegated every important role they were supposed to play to Madoff himself. As the purported custodian of investor assets, not only were they supposed to ensure that these assets were safeguarded, they were also supposed to ensure that trades actually occurred. However, they did neither. They delegated their custodial role to Madoff and then relied on him alone to provide trade information, never verifying that trades actually took place. Indeed, the UBS Defendants even knew of and condoned Madoff's use of backdated trade recommendations and allowed Madoff to operate in this manner. They hid these accommodations for Madoff from the Luxembourg regulator with respect to the Luxalpha fund, and never revealed Madoff's association with that fund as they were required to do. At the same time, the UBS Defendants ran from the consequences of their actions, entering into secret indemnity agreements with the Access Defendants. Their conduct speaks volumes of their knowledge of the fraud.

The Access Defendants, too, knew that Madoff was a fraud. They purposely relaxed their diligence standards for Madoff and, when they were told in 2006 by their own consultant that there were serious problems with Madoff, including the possibility of fraud, concealed these findings from all but the Access inner circle. Madoff was Access' biggest source of revenue, and they were not about to reveal the truth about him or end their lucrative relationship with him.

Significantly, Access's Littaye and Delandmeter both sat on the boards of Luxalpha, along with the Luxalpha Director Defendants, all of whom were UBS executives. Access's Littaye and Villehuchet were the Directors of Groupement. They all aided and abetted Madoff's breach of fiduciary duty as they allowed Madoff to operate free of checks and balances and under the radar of the Luxembourg regulator.

The Moving Defendants rely heavily on Judge Rakoff's recent decision in *Picard v. HSBC, plc, et al.*, Case Nos. 11-cv-763 (JSR) and 11-cv-836 (JSR), 2011 WL 3200298 (S.D.N.Y. July 28, 2011), to contend that the Trustee lacks standing to being his common law causes of action against them. The Trustee is appealing that decision, which, among other things, disregards three binding Second Circuit decisions that support the Trsutee's right to bring those claims here: *St. Paul Fire & Marine, Inc. v. Pepsi Co, Inc.*, 884 F.2d 688 (2d Cir. 1989); *Bankr. Servs. v. Ernst & Young* (*In re CBI Holding Co.*), 529 F.3d 432 (2d Cir. 2008): and *Redington v. Touche Ross & Co.*, 612 F.2d 68 (2d Cir. 1979). The Trustee's standing is clear under these cases and others.

First, the Trustee has standing to sue the Moving Defendants for their roles as contributing tortfeasors. In this regard, the doctrines of *in pari delicto* and the related *Wagoner* rule, which bar parties who are culpable from recovering against each other, are inapplicable. This is because, unlike other causes of action, a contribution action is predicated on parties' being *in pari delicto*. Not only is that fact no bar to recovery, it is the very basis for recovery.

Second, the Trustee has standing to sue the Moving Defendants as a "hypothetical judgment creditor" under Section 544(a) of the Bankruptcy Code, and based on "generalized harm to creditors." *St. Paul*, 884 F.2d at 701. While the Moving Defendants rely heavily on *Caplin v. Marine Midland Grace Trust Co. v. Manhattan Co.*, 406 U.S. 416 (1972), to contend that a trustee cannot bring creditor claims, this Circuit has made clear that as opposed to the particularized creditor claims that were at issue in *Caplin*, "[i]f a claim is a general one, with no particularized injury arising from it, and if that claim could be brought by any creditor of the debtor, the trustee is the proper person to assert the claim." *St. Paul*, 884 F.2d at 701. Thus, not only does the Trustee have standing, but the Trustee's standing is exclusive. Moreover, *Caplin* arose under the equivalent of Section 541 of the Bankruptcy Code, and did not address standing under § 544. *Caplin* simply has no application here. And neither do the doctrines of *in pari delicto* and the *Wagoner* rule, as the trustee stands in the shoes of an innocent creditor, not a malfeasant. Significantly, the trustee's standing under § 544 was never considered by the *HSBC* court.

Third, under *Redington*, the Trustee has standing as a bailee of customer property and the enforcer of SIPC's subrogation rights. As much as the Moving Defendants argue that *Redington* is no longer good law, they cannot escape the fact that the case has not been vacated. Their theories as to why it has no precedential value, which echo the *HSBC* decision, fly in the face of established rules of civil procedure. And, it is indisputable that the doctrines of *in pari delicto* and the *Wagoner* rule have no application to a bailee or an enforcer of subrogation rights, as again, the Trustee does not stand in the shoes of a malfeasant when he seeks recovery in these roles.

Fourth, in *CBI*, the Second Circuit unequivocally held that bankruptcy trustees can take assignments from creditors as against third parties under Section 541(a)(7) of the Bankruptcy Code. *Id*. The SIPA statute expressly incorporates this portion of the Code, and there is nothing in SIPA to preclude its application here. Tellingly, all of the cases relied on by the *HSBC* court and the Moving Defendants to the contrary pre-date the *CBI* decision. Thus, to the extent the Trustee receives assignments, he has standing to bring assigned claims.

Finally, as a separate matter, the Moving Defendants pretend that the Trustee is a class action plaintiff, and is barred from bringing his common law claims by the Securities Litigation

Uniform Standards Act ("SLUSA"). This ignores the fact that his actions are bought in order to fulfill his statutory obligations. Just like an ordinary bankruptcy trustee, he is excluded from the reach of SLUSA. The Moving Defendants should not be able to escape liability by relying on a statute which was never intended to preclude a fiduciary from fulfilling his statutory obligations.

It is time for the Moving Defendants to be held accountable for their misconduct. The Trustee is fully empowered under the Bankruptcy Code and SIPA to sue them for their complicity in Madoff's fraud. His claims should stand.

I. THE AMENDED COMPLAINT

The Trustee filed his original complaint on November 23, 2010, and amended it as of right on August 17, 2011. The Amended Complaint alleges that the Defendants enabled and profited from Madoff's Ponzi scheme through numerous international feeder funds, including the two feeder funds at issue in this proceeding—Luxalpha, a Luxembourg-based, open-ended investment fund, and Groupement, an investment fund organized under the laws of the British Virgin Islands. In exchange for lucrative fees, the UBS and Access Defendants worked closely together not only to create and expand Luxalpha and Groupement's investments into BLMIS, but also to maintain the fiction that careful due diligence was performed on Madoff and BLMIS, and that the UBS and Access Defendants were actively monitoring and managing the funds.

A. THE UBS AND ACCESS DEFENDANTS ENABLED MADOFF BY PROVIDING THE APPEARANCE OF LEGITIMACY AND SECURITY FOR LUXALPHA AND GROUPEMENT

UBS AG and its wholly-owned subsidiary, UBS SA, sponsored the formation of Luxalpha. (Am. Compl. ¶¶ 18-19.) UBS SA also formally served as Luxalpha's custodian, as well as Luxalpha's portfolio manager from February 2004 through August 2006. (*Id.* ¶ 19.) In addition, UBS SA served as the Prime Bank for Groupement. (*Id.*) UBSFSL, another wholly-owned subsidiary of UBS AG, served as the administrator of both Luxalpha and Groupement.

(*Id.* ¶ 20.) UBSTPM, which is, upon information and belief, a wholly-owned subsidiary of UBS AG, served as Luxalpha's portfolio manager beginning in August 2006 until November 2008. (*Id.* ¶ 21.) From its inception through its ultimate liquidation in 2009, the board of Luxalpha was dominated by UBS-based directors. (*Id.* ¶ 141.) Luxalpha Director Defendants Hartmann, Schroeter, Stiehl, Egger, Hondequin and Kranz were all UBS SA employees, and were responsible for all aspects of the fund. (*Id.*)

That UBS decided to serve as Luxalpha's sponsor was crucial in its obtaining approval as a UCITS[3] fund by the Commission du Surveillance du Secteur Financier (the "CSSF")—the Luxembourg regulator. (*Id.* ¶¶ 129-30.) UBS further provided a façade of legitimacy to Luxalpha, misleading the public into believing that the fund was endorsed and would be safeguarded by one of the world's largest financial institutions. (*Id.* ¶ 131.) Significantly, the UBS Defendants only outwardly lent their brand to the fund, while improperly delegating their custodial, administrative and managerial duties to Madoff. (*Id.* ¶ 143.) UBS delegated its custodial duties to Madoff, who became the sub-custodian of the fund, responsible for ensuring the existence of its assets. (*Id.* ¶ 134.) Madoff also provided trade information to UBS, and UBS never otherwise confirmed the existence of the trades. (*Id.* ¶¶ 5, 216.) There were thus no checks and balances, and UBS knew it because it helped design the very system that allowed Madoff's fraud. (*Id.* ¶ 131.)

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[3] A UCITS fund – an acronym for "Undertakings for Collective Investments in Transferable Securities" – is organized under a set of European Union ("EU") directives that aim to allow collective investment schemes to operate freely throughout the EU on the basis of a single authorization from one member state. In Luxembourg, in order to be approved as a UCITS fund, a fund must have a sponsor with a sound financial reputation and a capital base sufficient to provide compensation for any damages sustained by third parties as a result of fault in the management or administration of the fund. (Am. Compl. ¶¶ 128-130.)

The UBS Defendants worked closely with the Access Defendants in order to maintain the fiction that UBS actually held the assets of the Funds as custodian, was actually managing the Funds and was actually calculating the net asset value of the Funds based on verified information. (*Id.* ¶¶ 95-101.) Access International Advisors was founded in 1995 by Defendants Littaye and Villehuchet. (*Id.* ¶ 76.) Although formally distinct and separately organized in their various jurisdictions, AIA LLC, AIA Europe Ltd., AP (Suisse), Access Mgmt Lux, and AP (Lux) (collectively, "Access") were, in reality, a single business enterprise, or alter-egos of each other, which was, at all times relevant herein, coordinated, dominated and controlled by Littaye and Villehuchet. (*Id.* ¶ 77.)

Access touted its rigorous due diligence process, but special exceptions were made for Madoff and BLMIS. (*Id.* ¶ 201.) There was no rigor in Access's due diligence of Madoff and BLMIS, as its principals turned a blind eye to obvious indicia of fraud, even when they were told by their own consultant that there were serious problems with Madoff, including the possibility of fraud. (*Id.* ¶¶ 216-28.) The relationship with Madoff was considered at Access to be the basis for the company's cash flow, and the ability to provide European investors the opportunity to invest with Madoff was Access's most significant marketing and fundraising tool. (*Id.* ¶ 88.) Thus, not surprisingly, when it came to Madoff, there existed a significant discrepancy between what was represented and promised by the Access Defendants in terms of due diligence and monitoring and what was actually delivered.

B. THE DEFENDANTS WERE WELL AWARE OF THE INDICIA OF FRAUD SURROUNDING BLMIS

The Defendants were repeatedly faced with indicia of fraud surrounding Madoff and BLMIS, but decidedly ignored those signs of fraud and enabled the fraud. (*Id.* ¶¶ 172-79.)

There are numerous examples of the indicia of fraud surrounding BLMIS of which the Defendants were aware:

- Upon information and belief, neither BLMIS nor any BLMIS-feeder fund was ever placed on the list of Global Wealth & Business Banking recommendations for direct investment by the UBS Defendants for their clients. (*Id.* ¶ 104.) In addition, starting in as early as 2001, UBS AG analyzed multiple BLMIS-related funds and repeatedly declined to endorse them for distribution to UBS clients because of, *inter alia*, the lack of transparency regarding their ability to generate such high, stable returns and Madoff's refusal to meet with UBS AG's analysts. (*Id.* ¶¶ 108-117.)

- Just prior to the setup of Luxalpha, UBS SA reached out to other UBS entities for information on BLMIS, and received significant negative feedback, including recognition of the following red flags: (i) since 1990, there were only a handful of negative months, and the strategy generated incredibly consistent returns each year; (ii) the recognition that "[i]f Madoff were to run the strategy totally independently from his [broker/dealer business], it would be IMPOSSIBLE to generate the returns that he has produced since 1990;" and (iii) Madoff was acting as both a broker and a depository at once. (*Id.* ¶¶ 121-26.)

- In the spring of 2006, serious questions were raised at Access concerning the purported volume of options trades being reported by Madoff on the trade confirmations issued by BLMIS. (*Id.* ¶ 210.) Ultimately, the consultant hired to investigate the issue came to the conclusion that Madoff could not have executed the volume of options or underlying equities trades being claimed without negatively impacting the market price and diminishing his returns or even losing money. (*Id.* ¶¶ 216-17.) In fact, the options trades being reported for just Luxalpha and Groupement together exceeded the total volume for all put and call options traded on the Chicago Board of Exchange. (*Id.* ¶¶ 228-29.) However, the Access Defendants who sat on the boards of Luxalpha and Groupement, concealed the consultant's findings and conclusions. (*Id.* ¶¶ 220-227, 28-29, 31.)

- The Defendants also willfully ignored myriad other red flags: (i) the small, unknown auditor used by BLMIS; (ii) the fact that trades and positions were only reported in a hard-copy, paper format and on a delayed basis, which was particularly disturbing in view of Madoff's reputation in the industry for technological sophistication; (iii) the unusual secrecy insisted upon by Madoff; (iv) the unusually steady performance of BLMIS; (v) the unusual ability of BLMIS to enter and exit the market so as to consistently achieve very favorable prices; and (vi) the fact that the purported counterparties for Madoff's option trades were never identified. (*Id.* ¶¶ 231, 249-51.)

- Upon information and belief, and as set forth in the SEC Office of Inspector General's report dated August 30, 2009 (the "OIG Report"), the SEC's Enforcement Staff sent a draft document request to UBS's offices in the U.S. on June 16, 2006 in an attempt to verify whether any of UBS's European affiliates served as one of Madoff's purported OTC option counterparties as Madoff had claimed. (*Id.* ¶ 127.) The OIG Report details

> that, instead of providing the SEC with a direct answer, UBS's U.S. offices claimed to be unable to access the relevant data from Europe, and informed the SEC's Enforcement Staff that it would have to seek the relevant information directly from Europe. (*Id.*) However, the UBS Defendants knew in 2006 that they were not and never were one of Madoff's counterparties. (*Id.*)

Despite the numerous indicia of fraud surrounding Madoff and BLMIS, the UBS Defendants were more than willing to participate in Madoff's fraud because they decided that the potential lucrative fees they would receive far outweighed the potential risks due to fraud. They protected themselves through a series of undisclosed indemnity agreements entered into with the Access entities, which purported to indemnify and hold harmless the UBS-based directors and UBS SA for any liabilities resulting from their involvement with Luxalpha. (*Id.* ¶¶ 144-46.) Finally, UBS SA demanded that Access provide it with a letter from Luxalpha's investors holding UBS SA harmless for any loss incurred as a result of any failure of the sub-custodian, as well as proof of an insurance policy subscribed and paid for by Access covering the risks of Luxalpha. (*Id.* ¶ 147.)

C. THE DEFENDANTS' COVER-UP OF MADOFF'S INVOLVEMENT

Both the UBS Defendants and the Access Defendants knowingly participated in Madoff's fraud, and then attempted to conceal Madoff's involvement. Access Mgmt Lux provided UBS SA with backdated monthly investment recommendations, a practice which UBS knew of and endorsed in the October 10, 2008 Luxalpha Operating Memorandum. (*Id.* ¶ 178.) The backdated monthly investment recommendations served the purpose of deceiving the public and the regulators by making it appear as though UBS SA was directing Madoff and/or BLMIS when the opposite was true.

In addition, the UBS Defendants concealed Madoff's involvement in Luxalpha from the CSSF. Tellingly, no information about any delegation of the UBS Defendants' responsibilities to BLMIS appeared in any of Luxalpha's sales prospectuses or the required disclosures to the

CSSF. (*Id.* ¶¶ 161-62.) The 2009 Annual Report of the CSSF further confirms the deception perpetuated by the UBS Defendants. (*Id.* ¶ 163.) In that report, the CSSF states that the documents it received concerning the Luxalpha fund, upon which the CSSF based its decision to approve Luxalpha as a UCITS fund:

> did not contain any reference either to the identity of B[L]MIS or to the multiple responsibilities carried on *de facto* by one entity. Between the launch of [Luxalpha] and the breakout of the Madoff affair in December 2008, the CSSF was never informed in a transparent manner, by the professionals involved, of the structure actually set in place nor of the role played in practice by B[L]MIS at different levels of the structure.

(Id.)

Such deception is also evidenced by documents submitted to the CSSF on UBS SA's behalf. In a report dated January 15, 2008 and entitled "Control Report of the Independent Auditor on the Custodian Bank Function in the Context of the CSSF Circular 02/81," UBS SA purported to, as required by the CSSF, submit a list of funds for which UBS SA served as custodian, as well as a complete list of sub-custodians UBS SA utilizes globally. (*Id.* ¶ 164.) Despite the fact that Luxalpha was included among the funds listed in the report, neither Madoff nor BLMIS was identified as a sub-custodian and is otherwise nowhere to be found in the report. Instead the report submitted on behalf of UBS SA deceptively identifies Brown Brothers Harriman as the only sub-custodian used by UBS SA in the United States. (*Id.*)

The intentional failure to disclose Madoff's role with respect to Luxalpha was part of the UBS Defendants' overall scheme to shield Madoff and/or BLMIS from scrutiny so as not to upset the substantial stream of revenue that benefited the UBS Defendants as a result of their facilitation of and support for many BLMIS-related funds.

But for the Defendants' knowing participation in Madoff's fraud, the harm to BLMIS's victims would have been diminished. Accordingly, the Trustee has filed causes of action for recovery of fraudulent transfers and preferential transfers, disallowance of customer claims, equitable subordination of customer claims, aiding and abetting fraud, aiding and abetting breach of fiduciary duty, knowing participation in a breach of trust, conversion, unjust enrichment, and money had and received. (Am. Compl. ¶¶ 277-466.)

ARGUMENT

THE AMENDED COMPLAINT SHOULD STAND

I. THE MOVING DEFENDANTS HAVE WAIVED THE DEFENSE OF LACK OF PERSONAL JURISDICTION

While moving dispositively before the Court, the Moving Defendants have announced their intent to escape the results of any adverse ruling by later invoking Rule 12(b)(2) to contest the Court's ability to adjudicate this dispute based on lack of personal jurisdiction. The Moving Defendants have no right to appear before this Court and participate in dispositive motion practice and then -- in the event that their initial attempt to secure dismissal of the Complaint fails -- argue that this Court did not have the power over them to rule in the first instance.

Rule 12(h)(1) of the Federal Rules of Civil Procedure provides, in pertinent part, that a party waives the defense of lack of personal jurisdiction when it fails to raise that defense in either its first Rule 12 motion or in its responsive pleading. Fed. R. Civ. P. 12(h)(1)(B). "The message conveyed by . . . Rule 12(h)(1) seems quite clear. It advises a litigant to exercise great diligence in challenging personal jurisdiction . . .. If that party wishes to raise [the defense of lack of personal jurisdiction], that must be done at the time the first significant defensive move[] is made—whether it be by way of a Rule 12 motion or a responsive pleading." *JP Morgan Chase Bank, N.A. v. Law Office of Robert Jay Gumenick, P.C.*, No. 08 Civ. 2154 (VM), 2011 WL 1796298, at *2 (S.D.N.Y. Apr. 22, 2011) (quoting 5C Charles Alan Wright & Arthur R. Miller, 5C *Federal. Practice. & Procedure* § 1391 (3d ed. 2010)).

While this Court ordered the Moving Defendants to brief the threshold issues of standing and SLUSA preemption, this was not an invitation to play fast and loose with the rules. The Moving Defendants had the opportunity to bring to the Court's attention their anticipated defense of lack of personal jurisdiction in their letters to the Court on the standing and SLUSA issues. Instead, they remained silent at that time and now simply assert that they intend to "preserve any and all defenses to [P]laintiff's claims" in their brief. (UBS Br. at 1 n.1; Access Br. at 3 n.2.) The Court's briefing order did not exempt the Defendants from compliance with the rule governing dispositive motion practice established by Rule 12(h)(1). Rather, it merely relieved the Defendants from briefing anything other than their standing and SLUSA arguments at this time. They could have, and indeed should have, identified all of their Rule 12(b) objections in their motion – even if briefing on some of those objections was temporarily held in abeyance. The Moving Defendants cannot hide behind this Court's briefing order to engage in dispositive motion practice and, if it does not go their way, later contest personal jurisdiction.

The Moving Defendants' attempt to "preserve" the defense of lack of personal jurisdiction by simply announcing their intent to contest the Court's jurisdiction at a later point in time is inadequate. (*See* UBS Br. at 1 n.1; Access Motion at 4.) This approach is procedurally improper and has been rejected in the Southern District of New York. *See, e.g.*, *Bryant Park Capital v. Jelco Ventures*, No. 05 Civ. 8702 (GEL), 2005 WL 3466013, at *1 (S.D.N.Y. Dec. 16, 2005) ("Defendants are mistaken in contending that they 'do not waive' *any* of the listed objections [by "assert[ing], in passing, that . . . they 'do not waive' any future objection" to personal jurisdiction]; the failure to properly raise a Rule 12(b)(2) motion for lack of personal jurisdiction at this juncture is preclusive."). There is good reason for this. As the Supreme Court has recently emphasized, the question whether a Court can properly exercise personal jurisdiction over a defendant is of paramount importance because "whether a judicial judgment is lawful depends on whether the sovereign has the authority to render it." *J. McIntyre Machinery, Ltd. v. Nicastro*, 131 S. Ct. 2780, 2789 (2011).

The Court should not permit the Moving Defendants to have it both ways—allowing the Court to rule on a dispositive motion and running from that ruling if it does not go their way. The Court should rule that they have waived their opportunity to challenge personal jurisdiction at a later time.

II. THE BANKRUPTCY CODE ALLOWS THE TRUSTEE TO STAND IN THE SHOES OF THE DEBTOR TO BRING A CONTRIBUTION CLAIM, WHICH THE TRUSTEE HAS SUFFICIENTLY ALLEGED

By virtue of the conduct detailed above, the Moving Defendants are joint tortfeasors. A SIPA trustee, like an ordinary bankruptcy trustee, is permitted to step into the shoes of the debtor for the purpose of bringing the debtor's state law claims, including state law contribution claims against the debtor's joint tortfeasors. Both the Trustee's right to bring a contribution claim and the underlying tort claim itself emanate from New York state law, law that the Moving Defendants ignore when they argue the Trustee has no authority under SIPA to seek contribution.

A. SIPA and the Bankruptcy Code Authorize the Trustee to Bring a State Law Contribution Claim

The Bankruptcy Code, expressly incorporated by SIPA, grants the Trustee standing to bring state law claims, including contribution claims. The Moving Defendants' arguments to the contrary, which are based on the *HSBC* decision, are mistaken. *See HSBC*, 2011 WL 3200298, at *10; (JPMC Br. 63–64.)

Section 78fff(b) of SIPA expressly incorporates portions of title 11 of the Bankruptcy Code, and § 541(a)(1) of the Bankruptcy Code makes clear that the "estate is comprised of . . .

all legal or equitable interests of the debtor in property as of the commencement of the case." 15 U.S.C. § 78fff(b); 11 U.S.C. § 541(a)(1). Included in this property are all "choses in action" and claims the debtor has against others as of the commencement of the case. H. R. Rep. No. 95-595 at 158, 332 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6136, 6323; S. Rep. No. 95-989 at 79 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5868; *Air Line Pilots Ass'n, Int'l v. Am. Nat'l Bank & Trust Co. of Chicago* (*In re Ionosphere Clubs, Inc.*), 156 B.R. 414, 436–37 (S.D.N.Y. 1993), *aff'd*, 17 F.3d 600 (2d Cir. 1994) ("A debtor's interests in property, including causes of action, are defined by state law, and become assets of the estate once the bankruptcy petition is filed.").

BLMIS and the Moving Defendants are joint tortfeasors in that they each committed torts that resulted in the same harm to BLMIS customers. *See* N.Y. C.P.L.R. § 1401 (McKinney 1997). As a joint tortfeasor, BLMIS is entitled to contribution from the Moving Defendants for any liability BLMIS would have for those injuries. *Id.* These torts were committed prior to the commencement of the SIPA Proceeding. A debtor may have a contribution claim under N.Y. C.P.L.R. § 1401 for torts committed prior to the commencement of the proceeding. *See In re JMK Constr. Grp., Ltd.*, 441 B.R. 222, 231–33 (Bankr. S.D.N.Y. 2010).

The Trustee acquired BLMIS's contribution cause of action as property of the estate under § 541(a)(1) upon the commencement of the SIPA proceeding. This contribution claim is the same as any other cause of action a bankruptcy trustee would acquire from the debtor as of the commencement of a bankruptcy proceeding. Accordingly, the Trustee is the appropriate party to bring this contribution claim against the Moving Defendants.

B. The Trustee's Underlying Tort Claim Emanates from New York Law, Not from a Breach of a Federal Statute

Citing to the *HSBC* decision, the Moving Defendants argues that the Trustee's contribution claim fails because SIPA does not give the Trustee the right to bring that claim. (JPMC Br. 64–65.) That argument, however, only applies where the tort claim underlying the contribution arises from the breach of a federal statute. That is not the case here, where the underlying tort arises under New York state law.

The Trustee's right to contribution is based on breaches or violations of obligations imposed by state tort law, such as the obligation not to commit fraud or breach fiduciary duties. *See LNC Invs., Inc. v. First Fid. Bank, N.A.*, 935 F. Supp. 1333, 1348–49 (S.D.N.Y. 1996); *see also Nw. Airlines, Inc. v. Transp. Workers Union of Am., AFL-CIO*, 451 U.S. 77, 97 n.38 (1981) ("[F]ederal courts . . . have recognized a right to contribution under state law in cases in which state law supplied the appropriate rule of decision.").

The *LNC Investments* court explained the distinction between a contribution claim based on an underlying breach of a federal statute and a contribution claim based on an underlying violation of state tort law. 935 F. Supp. at 1340–49. There, investors in a trust sued several trustees after the owners of the trust went bankrupt, alleging that the trustees had violated the Trust Indenture Act's ("TIA") prudent person requirement and breached fiduciary duties under the TIA and New York common law. *Id.* at 1336. A trustee that had been sued by the investors ("trustee A") moved to implead a trustee that had not initially been sued ("trustee B") seeking contribution under the TIA and New York common law. *Id.*

The court denied the motion to implead based on the claim for contribution under the TIA, finding no evidence that Congress intended to create a right to contribution under the federal statute. *Id.* at 1340–46. But the court allowed trustee A to implead trustee B for contribution on the basis of the New York state tort law claims. *Id.* at 1346–49. The court explained that "[b]ecause plaintiff alleges that [trustee A] has committed the tort of a breach of fiduciary duty, and because that tort exists under New York law, [trustee A] may seek contribution from joint tort-feasors." *Id.* at 1348. Trustee B was a joint tortfeasor because if found liable, he had caused the "same injury" to the investors as trustee A. *Id.* A contribution claim existed under state law because the source of the right to contribution was "an obligation imposed by state law." *Id.* at 1349.

The cases relied on by the Moving Defendants and in *HSBC* for the proposition that the Trustee may not seek contribution under New York state law are inapposite because the plaintiffs in those cases attempted to allege a New York state law contribution claim based on a breach of a federal act (specifically, the Copyright Act). *See KBL Corp. v. Arnouts*, 646 F. Supp. 2d 335, 339–41 (S.D.N.Y. 2009) (attempting to bring state law contribution claim based on liability for copyright infringement under the Copyright Act); *Lehman Bros., Inc. v. Wu*, 294 F. Supp. 2d 504, 505 n.1 (S.D.N.Y. 2003) (same). In contrast, the Trustee is alleging a New York state law contribution claim based on torts committed by BLMIS and the Moving Defendants in violation of New York state law.

C. The Trustee Has Sufficiently Alleged a Contribution Claim

The Moving Defendants' contention that the Trustee has failed to allege the elements of a contribution claim is also incorrect. (*See* JPMC Br. 65–67.) "[T]wo or more persons who are subject to liability for damages for the same . . . injury to property . . . may claim contribution among them whether or not an action has been brought or a judgment has been rendered against the person from whom contribution is sought." N.Y. C.P.L.R. § 1401. The Trustee has alleged that BLMIS and the Moving Defendants are joint tortfeasors subject to liability for the same injury: the losses incurred by BLMIS customers. (Am. Compl. ¶¶ 349–461.) Contrary to the

Moving Defendants' claim, and as explained further below, the Trustee has adequately alleged tort claims against the Moving Defendants. On a motion to dismiss, it is enough that the Trustee has adequately alleged that the Moving Defendants have tort liability; the Trustee need not prove the Moving Defendants are actually liable in tort until trial. *See LNC Invs.*, 935 F. Supp. at 1349.

The Moving Defendants, relying on *dicta* in the *HSBC* decision, also contend that the Trustee's obligation to pay customer claims under SIPA does not meet the New York contribution statute's requirement that the party seeking contribution be subject to liability for damages. (JPMC Br. 64–65) (citing *HSBC Bank*, 2011 WL 3200298, at *10).) Courts in New York have interpreted § 1401's liability requirement to mean that the Trustee must be "compelled in some way . . . to make the payment against which contribution is sought." *N.Y. State Elec. & Gas Corp. v. FirstEnergy Corp.*, No. 3:03-CV-0438 (DEP), 2007 WL 1434901, at *7 (N.D.N.Y. May 11, 2007); *see also Hill v. Day* (*In re Today's Destiny, Inc.*), 388 B.R. 737, 750–51 (Bankr. S.D. Tex. 2008). Although the compulsion to pay may commonly take the form of a money judgment, the statute does not, as the *HSBC* decision and the Moving Defendants summarily imply, so require—other compulsions to pay will suffice. *See FirstEnergy Corp.*, 2007 WL 1434901, at *7 (allowing a contribution claim arising out of consensual administrative orders because the orders imposed "tort-like liability"). The compulsion to pay in this case is the Trustee's obligation to pay customer claims under SIPA.

Today's Destiny upheld a contribution claim in similar circumstances. 388 B.R. at 751. In that case, a debtor had committed fraud in the sale and leasing of equipment and the purchasers of the equipment filed nearly 300 proofs of claim against the bankruptcy estate. *Id.* at 750–51. The bankruptcy trustee brought contribution claims against certain lenders based on allegations that the lenders had aided and abetted the debtor's fraud. *Id*. at 750. The court found that the trustee had stated a valid claim for contribution under Texas state law, *id.* at 751, and explained that "[a]fter the objection deadline passes and all objections have been resolved, [the debtor's] liability for [the] claims will be fixed pursuant to Court orders." *Id.* at 755. Accordingly, the estate had a contribution right against the lenders to the extent the court's orders allowed the customers' proofs of claim. *Id.* The same outcome is appropriate here.

Under the Moving Defendants' view of contribution, SIPA and the Bankruptcy Code would have the contrary effect of shielding third-party tortfeasors who, along with the broker-dealer, harmed the broker-dealer's customers, from the contribution claims that the joint tortfeasors would otherwise face. As with any bankruptcy proceeding, the victims are not permitted to bring tort claims against the BLMIS estate by virtue of the automatic stay. *See SEC v. Bernard L. Madoff*, 08-CIV-10791 (LLS), Dkt. No. 4 (S.D.N.Y. Dec. 15, 2008); 11 U.S.C. § 362(a); 15 U.S.C. § 78eee(b)(2)(B)(i). Instead, in order to be compensated for their losses, the customers must file claims in the Bankruptcy Court pursuant to the customer claims procedure. In the absence of a bankruptcy or SIPA proceeding, the customers would be able to bring tort claims against BLMIS, and the Moving Defendants, as joint tortfeasors, would be liable for contribution for its share of the customers' injuries. A finding that SIPA shields a broker-dealer's joint tortfeasors from liability they would otherwise face would be inconsistent with the purpose of SIPA.

Similarly, the Moving Defendants' argument that "the Trustee has failed to plead that BLMIS has paid—or ever will pay—more than its 'equitable share' of any judgment, as required to state a contribution claim" has no merit. (JPMC Br. 66.) The Trustee has impleaded the Moving Defendants into the SIPA proceeding, which is where BLMIS's liability ultimately will be determined. (Am. Compl. ¶ 16.) Where a plaintiff seeks contribution by way of impleader, New York does not require the plaintiff to establish a compulsion to make payment beyond that party's equitable share. *See*, *e.g.*, *Andrulonis v. United States*, 26 F.3d 1224, 1233 (2d Cir. 1994) ("In a federal case governed by New York law, Rule 14(a) nevertheless permits a defendant to implead a joint tortfeasor for contribution before the right to contribution accrues, because that third party 'may be' liable to the defendant for a share of the plaintiff's primary judgment."); *Klinger v. Dudley*, 41 N.Y.2d 362, 369 (1977) ("[A] main defendant may assert his claim for contribution prior to the payment of any amount to the plaintiff.").

The reason behind this rule is to promote judicial efficiency. The amount that BLMIS will be compelled to pay and what represents its "equitable share" have not yet been finally determined, as the claims allowance process is ongoing. (*See* Am. Compl. ¶ 16.) To the extent it becomes necessary for the Trustee to move to implead the Moving Defendants into the individual contested claims proceedings, the Trustee will do so under Federal Rule of Bankruptcy Procedure 9014. *See* Fed. R. Bankr. P. 9014(c) ("The court may at any stage in a particular matter direct that [the impleader rule] shall apply."). The Moving Defendants' compulsion to pay will ultimately be determined upon final resolution of the SIPA proceeding. The Trustee is not required to allege the scope of liability before it is determined.

III. THE BANKRUPTCY CODE ALLOWS THE TRUSTEE TO STAND IN THE SHOES OF A JUDGMENT CREDITOR AND ASSERT COMMON LAW CLAIMS AGAINST THE MOVING DEFENDANTS

In addition to claims belonging to the debtor, the Trustee is also empowered to bring claims standing in the shoes of an innocent judgment creditor under §544(a) of the Bankruptcy Code. Under that provision, the Trustee has standing to sue third parties under two different theories. First, the Trustee has standing to bring claims that, like the ones here, allege harm to all creditors, and his standing to bring those claims is exclusive in this Circuit: "If a claim is a general one, with no particularized injury arising from it, and if that claim could be brought by any creditor of the debtor, the trustee is the proper person to assert the claim." *St. Paul*, 884 F.2d at 701. Second, the Trustee has standing under § 544(a) and New York law to appropriate the debtor's causes of action against third parties to satisfy the Trustee's hypothetical unsatisfied judgment. And when the Trustee does so, he asserts those causes of action free of *in pari delicto.*

A. The Trustee Has Standing Under Section 544(a) of the Bankruptcy Code to Bring Common Law Claims Against the Moving Defendants as a Hypothetical Judgment Creditor

Under Bankruptcy Code § 544(a), the Trustee has standing to assert his common law causes of action, free of any personal defenses such as *in pari delicto*, as a "hypothetical judgment creditor." Section 544(a) provides in pertinent part that:

> The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—
>
> (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists; [or]
>
> (2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists . . . .

11 U.S.C. § 544(a). These rights and powers are commonly referred to as a trustee's "strong arm powers." *See Musso v. Ostashko*, 468 F.3d 99, 102 (2d Cir. 2006).

What is a "hypothetical judgment creditor?" Put simply, § 544(a) places a trustee in the shoes of a hypothetical creditor who obtained a judgment against the debtor, allowing the trustee to exercise all of "the rights and powers" of such a creditor resulting from the fact that the judgment remains unsatisfied. It does not matter whether such a creditor actually exists or what the judgment is for. In other words, if a creditor could have obtained a judgment against the debtor—even if none did—the trustee has all of the rights and powers of that creditor, including the ability to assert causes of action, as permitted under relevant state law. *See id.* at 105 ("Section 544(a)(1) thus puts the trustee in the position of an ideal lien creditor, armed with a judgment and with all the power that state law confers on such ideal creditors."); *see also Cent. Hanover Bank & Trust Co. v. Manhattan Co.*, 105 F.2d 130, 131 (2d Cir. 1939) (L. Hand, J.) ("The trustee is vested . . . with all the powers of a judgment creditor" under predecessor to § 544); *Pereira v. Checkmate Commc'ns Co.* (*In re Checkmate Stereo & Elecs., Ltd.*), 9 B.R. 585, 591 (Bankr. E.D.N.Y. 1981) ("[Section 544] gives the trustee in bankruptcy every right and power which is conferred by the law of the state upon its most favored creditor who has acquired a lien by legal or equitable proceedings.'") (internal quotations and citations omitted).

As the Tenth Circuit has explained:

> To understand the full import of [section] 544, one must first understand the power of a bankruptcy trustee to stand in the shoes of a[n] hypothetical creditor of the debtor to effect a recovery from a third party. Simply stated, from the reservoir of equitable powers granted to the trustee to maximize the bankruptcy estate, Congress has fashioned a legal fiction. *Not only is a trustee empowered to stand in the shoes of a debtor to set aside transfers to third parties, but the fiction permits the trustee also to assume the guise of a creditor with a judgment against the debtor. Under that guise, the trustee may invoke whatever remedies provided by state law to judgment lien creditors to satisfy judgments against the debtor.*

Zilkha Energy Co. v. Leighton, 920 F.2d 1520, 1523 (10th Cir. 1990) (emphasis added).

Under this section of the Bankruptcy Code, the Trustee can assert his common law claims against the Moving Defendants standing in the shoes of a judgment creditor.

B. As a Hypothetical Judgment Creditor, the Trustee Possesses All of the Rights and Powers of an Unsatisfied Judgment Creditor of BLMIS Under New York Law

Unlike claims brought under 11 U.S.C. § 541(a)(1), which are brought by a trustee standing in the shoes of the debtor, a trustee brings claims under § 544(a) standing in the shoes of an innocent creditor. *See, e.g., Fundex Capital Corp. v. Balaber-Strauss* (*In re Tampa Chain Co.*), 53 B.R. 772, 777–78 (Bankr. S.D.N.Y. 1985); *Official Comm. of Unsecured Creditors of Am.'s Hobby Ctr., Inc. v. Hudson United Bank* (*In re Am.'s Hobby Ctr., Inc.*), 223 B.R. 275, 287 (Bankr. S.D.N.Y. 1998) (quoting N.Y. C.P.L.R. 5202(a)).

Section 544(a) expressly grants a trustee whatever "rights and powers" a creditor with an unsatisfied judgment would have under state law. Those rights and powers include the ability to assert two types of claims.

The first type of claim is a cause of action that all general creditors of the judgment debtor possess, namely, a cause of action asserting generalized harm to all creditors. *See Hill v. Gibson Dunn & Crutcher, LLP* (*In re MS55, Inc.*), No. 06-cv-01233-EWN, 2007 WL 2669150, at *12 (D. Colo. Sept. 6, 2007) (when trustee asserts claims as hypothetical judgment creditor, he "is necessarily asserting claims general to any and all judgment . . . creditors"); *Fisher v. Am. Nat'l Bank & Trust Co. of Chicago* (*In re Elite Mktg. Enters., Inc.*), No. 99 B 29921, 2001 WL 1669229, at *4 (Bankr. N.D. Ill. Dec. 13, 2001) (trustee has standing "to prosecute general claims of unsecured creditors under § 544 of the Bankruptcy Code . . . [t]he trustee can proceed if he alleges . . . a 'general' injury to the unsecured creditors").

The second type of claim that a judgment creditor can bring is a "chose in action"—a cause of action, originally belonging to the debtor, that the judgment creditor can enforce to help satisfy the creditor's unsatisfied judgment against the debtor. *See Koch Ref. v. Farmers Union Cent. Exch.*, 831 F.2d 1339, 1342–49 (7th Cir. 1987) ("Pursuant to 11 U.S.C. § 544 the trustee, in his capacity as creditor, may bring suit to reach property or choses in action belonging to the estate that will then be distributed to all creditors.").

The powers of the hypothetical judgment creditor are determined by state law, in this case New York law. *Robinson v. Howard Bank* (*In re Kors, Inc.*), 819 F.2d 19, 22–23 (2d Cir. 1987) ("Once the trustee has assumed the status of a hypothetical lien creditor under § 544(a)(1), state law is used to determine what the lien creditor's priorities and rights are.") (internal citations omitted).

C. Standing in the Shoes of a Hypothetical Judgment Creditor, the Trustee Can Bring Common Law Claims Directly Against the Moving Defendants

Under New York law, once a company becomes insolvent, its officers and directors owe fiduciary duties directly to its creditors under the "trust fund doctrine." *RSL Commc'ns PLC v. Bildirici*, 649 F. Supp. 2d 184, 202 (S.D.N.Y. 2009). Under this doctrine, "'officers and directors of an insolvent corporation are said to hold the remaining corporate assets in trust for the benefit of its general creditors.'" *Id.* (quoting *Credit Agricole Indosuez v. Rossiyskiy Kredit Bank*, 94 N.Y.2d 541, 549 (2000)). Therefore, "'directors of an insolvent corporation owe a fiduciary duty to preserve the assets of the corporation for the benefit of creditors.'" *Bildirici*, 649 F. Supp. 2d at 202 (quoting *Hughes v. BCI Int'l Holdings, Inc.*, 452 F. Supp. 2d 290, 308 (S.D.N.Y. 2006)); *see also Clarkson Co. v. Shaheen*, 660 F.2d 506, 512 (2d Cir. 1981); *N.Y. Credit Men's Adjustment Bureau, Inc. v. Weiss*, 110 N.E.2d 397, 398 (N.Y. 1953). The trust fund doctrine serves "the New York policy to preserve the assets of insolvent corporations for the creditors." *Clarkson*, 660 F.2d at 512 (citing *Ward v. City Trust Co. of N.Y.*, 84 N.E. 585, 589 (N.Y. 1908)).

These principles apply with equal force to a limited liability company. *See, e.g., Kittay v. Atl. Bank of N.Y.* (*In re Global Serv. Grp., LLC*), 316 B.R. 451, 460 (Bankr. S.D.N.Y. 2004) (applying trust fund doctrine to LLC); *Bildirici*, 649 F. Supp. 2d at 213 (same as to PLC); *see generally Tzolis v. Wolff*, 10 N.Y.3d 100, 104–09 (N.Y. 2008) (applying corporate derivative liability concepts to LLCs); *Gitlin v. Chirinkin*, No. 012131/07, 2011 WL 3276708, at *6 (N.Y. Sup. Ct. Nassau County June 29, 2011) (describing fiduciary duties in LLC context).

Because Madoff perpetrated a Ponzi scheme, BLMIS has been insolvent since the Ponzi scheme began. *See Cunningham v. Brown*, 265 U.S. 1, 8 (1924) (given his fraudulent scheme, Charles Ponzi "was always insolvent, and became daily more so, the more his business succeeded"); *Warfield v. Byron*, 436 F.3d 551, 558 (5th Cir. 2006) (same); *Daly v. Deptula* (*In re Carrozzella & Richardson*), 286 B.R. 480, 486 n.17 (D. Conn. 2002) (same).

Because BLMIS was insolvent over the life of the scheme, Madoff, in his role as an officer and member of BLMIS, owed duties to BLMIS's creditors to preserve its assets. *See Bildirici*, 649 F. Supp. 2d at 202; *Hughes*, 452 F. Supp. 2d at 308 (citing *Clarkson*, 660 F.2d at 512, and *Weiss*, 110 N.E.2d at 400).[4] Accordingly, whatever causes of action arise from a violation of those duties accrue to creditors damaged by Madoff's scheme and are thus, by virtue of § 544(a), causes of action that the Trustee possesses. And clothed in the guise of a creditor, the Trustee's causes of action are not limited to those against the debtor (which in liquidation, would take the form of a proof of claim), but may be brought against third parties that also damaged creditors. *See, e.g.*, *In re Elite Mktg. Enters.*, 2001 WL 1669229, at *4 (trustee had standing to assert "general" injury to unsecured creditors through unjust enrichment claim against third party bank that had assisted debtor in falsifying loan documents and thereby harmed those that may have lent additional money to the debtor under false pretenses).

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[4] While a trustee stands in the shoes of a hypothetical judgment creditor as of the commencement of the liquidation under § 544(a), liability for improperly wasting company assets extends to acts taken before the judgment. *See, e.g., Aktieselskabet Christianssand v. Fed. S.S. Corp.*, 201 N.Y.S. 504, 506 (Sup. Ct. N.Y. County 1923) ("a subsequent creditor can rely upon the assumption that the capital of a corporation has not been depleted by illegal conduct of the directors.").

The "trust fund doctrine" confers standing on a creditor—whether by virtue of a judgment or otherwise—to assert causes of action against a company's officers and directors, as well as third party aiders and abettors, which derive from the officer or director's diversion of corporate assets for his own benefit to the detriment of the enterprise and its creditors. *See generally In re Mortg. Am. Corp.*, 714 F.2d 1266, 1276 (5th Cir. 1983). Here, the gravamen of the Trustee's common law claims is that the Moving Defendants caused billions of dollars in damages to BLMIS's creditors by aiding Madoff in perpetuating his Ponzi scheme—by, among other things, aiding and abetting Madoff's fraud, breach of fiduciary duty and conversion, unlawfully converting creditor funds, knowingly participating in a breach of trust, and being unjustly enriched at the expense of creditors. The Trustee has statutory standing under § 544(a) to assert these claims as a judgment creditor.

In *Gibson Dunn*, the debtor filed a chapter 11 petition after financial transactions involving two of its biggest investors failed. 2007 WL 2669150, at *2. The case was ultimately converted to a chapter 7 proceeding, at which point the trustee asserted various common law claims against attorneys who had acted as the debtor's legal counsel during the financial transactions. *Id.* at *2–3. These included breach of fiduciary duty, conspiracy, legal malpractice, negligence, aiding and abetting breach of fiduciary duty, and securities fraud. *Id.* at *3, *5. The district court concluded that creditors would have had the right to assert those causes of action under applicable state law, and further held that acting as a hypothetical judgment creditor, the trustee similarly could assert such causes of action under § 544(a). *See id.* at *10–15; *see also Lumbard v. Maglia, Inc.*, 621 F. Supp. 1529, 1542 (S.D.N.Y. 1985) (under § 544, trustee could bring RICO claims against those who aided and abetted the diversion of the debtor's assets:

"Section 544, the 'strong arm' provision, provides ample statutory authority for a Chapter 7 trustee's assertion of creditors' claims against third parties").

Atypical of most chapter 7 and 11 cases, BLMIS was a massive Ponzi scheme, insolvent from the scheme's inception, in which the Trustee has alleged that the Moving Defendants aided and prolonged the scheme. It is precisely for these reasons that the claims for breaches of fiduciary duty and other actionable harms caused by third parties, *i.e.*, the Moving Defendants, exist. BLMIS, as found by the Second Circuit in its "net equity decision," stands as an "extraordinary" case of fraud both for its breadth and duration. *In re Bernard L. Madoff Inv. Sec. LLC*, No. 10-2378-bk, 2011 WL 3568936, at *8 (2d Cir. Aug. 16, 2011). The Trustee's invocation of § 544(a) to bring common law claims against the Moving Defendants in his capacity as a judgment creditor is part and parcel of the tool kit granted by Congress to bankruptcy trustees to maximize the estate's recovery for the benefit of all creditors. *See Faircloth v. Paul* (*In re Int'l Gold Bullion Exch., Inc.)*, 60 B.R. 261, 264 (Bankr. S.D. Fla. 1986).

D. The Trustee Can Also Bring Claims of BLMIS Against the Moving Defendants, as Those Claims are Assignable Under New York Law to an Unsatisfied Judgment Creditor

New York law provides that a creditor whose judgment is unsatisfied can enforce it against any of the debtor's property, including causes of action (also termed "choses in action"). *See generally* N.Y. C.P.L.R. § 5201(a) ("[A] money judgment may be enforced against . . . a cause of action which could be assigned or transferred accruing within or without the state."). The Trustee, standing in the shoes of a hypothetical judgment creditor under § 544(a), has had his judgment returned unsatisfied. Accordingly, he can look to satisfy that judgment by enforcing choses in action that belong to the debtor. *See Koch Ref.*, 831 F.2d at 1342 ("Pursuant to 11 U.S.C. § 544 the trustee, in his capacity as creditor, may bring suit to reach property or choses in action belonging to the estate that will then be distributed to all creditors"); *Port*

Chester Elec. Constr. Corp. v. Atlas, 40 N.Y.2d 652, 657 (1976) (judgment creditor may enforce causes of action that the judgment debtor possesses).

Under New York law, causes of action are freely assignable with certain limited exceptions not applicable here. *See* N.Y. G.O.L. § 13-101; *Semi-Tech Litig., L.L.C. v. Ting*, 787 N.Y.S.2d 234, 236 (1st Dep't 2004) (assignment of claims for fraud and aiding and abetting fraud); *Client's Sec. Fund of the State of N.Y. v. Goldome*, 560 N.Y.S.2d 84, 87 (N.Y. Sup. Ct. 1990) (conversion); *Skilled Investors, Inc. v. Bank Julius Baer & Co.*, 878 N.Y.S.2d 53, 54 (1st Dep't 2009) (unjust enrichment); *Certain Underwriters at Lloyd's, London v. Foster Wheeler Corp.*, 822 N.Y.S.2d 30, 40–41 (1st Dep't 2006) (contribution); *see also O'Halloran v. PricewaterhouseCoopers LLP*, 969 So. 2d 1039, 1048–49 (Fla. App. 2007) (aiding and abetting breach of fiduciary duty claim).

As BLMIS possesses claims against the Moving Defendants for aiding and abetting Madoff's fraud, conversion, and breach of fiduciary duty, as well as for conversion, unjust enrichment, and knowing participation in Madoff's breach of trust, the Trustee can look to satisfy his unsatisfied judgment through the enforcement of those claims under New York law.

As discussed below, even if those claims would be barred by *in pari delicto* if brought under § 541—because under that section the Trustee stands in the shoes of the debtor, subject to the defenses to which the debtor is subject—*in pari delicto* would not bar those actions when the Trustee stands in the shoes of an innocent creditor. *See, e.g.*, *Geltzer v. Mooney* (*In re MacMenamin's Grill Ltd.*), 450 B.R. 414, 431 (Bankr. S.D.N.Y. 2011) (the *Wagoner* Rule and *in pari delicto* do not apply to a trustee "who has independent standing under section 544"); *Cent. Hanover*, 105 F.2d at 131–32 (L. Hand, J.) ("there are occasions when [a trustee] may represent creditors when the defendant would have had no standing").

Accordingly, whether the common law causes of action that the Trustee asserts are viewed as direct actions brought in the shoes of a judgment creditor, or are viewed as claims that originally belonged to the debtor that are enforced by a judgment creditor under New York law, the Trustee has standing to assert them under § 544(a).[5]

E. The Trustee's Standing to Bring These Claims Is Exclusive

The claims against the Moving Defendants alleged by the Trustee standing in the shoes of a judgment creditor assert a generalized harm common to all creditors as a result of the Moving Defendants' alleged actions in facilitating the Ponzi scheme and deepening BLMIS's insolvency. *See e.g., Gibson Dunn*, 2007 WL 2669150, at *12. Because the claims that the Trustee asserts involve a generalized injury to all creditors, the Trustee is the only one who can assert such claims in a liquidation proceeding. "If a claim is a general one, with no particularized injury arising from it, and if that claim could be brought by any creditor of the debtor, the trustee is the proper person to assert the claim." *St. Paul*, 884 F.2d at 701; *Kagan v. Saint Vincents Catholic Med. Ctrs. of N.Y.* (*In re Saint Vincents Catholic Med. Ctrs. of N.Y.*), 449 B.R. 209, 218 (S.D.N.Y. 2011) (agreeing that "the trustee had exclusive standing to bring causes of action that generally affect all creditors"). Thus, the Trustee's standing to bring his common law claims against the Moving Defendants under § 544(a) is wholly consonant with established Second Circuit precedent.

F. Section 544(a) Is Not Limited to Avoidance Actions

The Moving Defendants argue that it is "settled law" that § 544(a) applies only to avoidance actions, and fails to address the matter further. (JPMC Br. 11 n.4.) But numerous

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[5] Accordingly, "[w]hether a creditor's cause of action is direct or derivative has nothing to do with the issue of whether a judgment-lien creditor has the right to bring the action." *Hill v. Gibson Dunn & Crutcher, LLP* (*In re MS55, Inc.*), No. 06-cv-01233-EWN, 2008 WL 2358699, at *2 (D. Colo. June 6, 2008).

cases have held that § 544(a) applies to more than avoidance actions. *See Gibson Dunn*, 2007 WL 2669150, at *10–12 (claims for civil conspiracy and aiding and abetting breach of fiduciary duty); *Sender v. Porter* (*In re Porter McLeod, Inc.*), 231 B.R. 786, 792–93 (D. Colo. 1999) (professional malpractice and aiding and abetting breach of fiduciary duty claims against certain third parties); *Sender v. Mann*, 423 F. Supp. 2d 1155, 1173–74 (D. Colo. 2006) (aiding and abetting breach of fiduciary duty, aiding and abetting fraud, legal malpractice, and civil conspiracy claims against certain third parties); *Collins v. Kohlberg & Co.* (*In re Sw. Supermarkets, LLC*), 325 B.R. 417, 425–26 (Bankr. D. Ariz. 2005) ("some kinds of affirmative damages actions can be asserted under § 544(a)(2), not just avoidance of secret liens"); *Koch Ref.*, 831 F.2d at 1342–43 (state law alter ego action against corporation's fiduciaries); *Keene Corp. v. Coleman* (*In re Keene Corp.*), 164 B.R. 844, 851 (Bankr. S.D.N.Y. 1994) (trustee's "strong arm" powers permit trustee to assert state law claims belonging to creditors); *Lumbard*, 621 F. Supp. at 1542 (RICO claims against third parties).

It is these cases that hew to the plain language of the statute. Section 544(a) provides that a trustee has "the rights and powers of" a hypothetical judgment creditor *or* the ability to "avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by" a hypothetical judgment creditor. 11 U.S.C. § 544(a) ("The trustee shall have . . . the rights and powers of, or may avoid any transfer of property of the debtor . . .").

The use of the conjunction "or" in the statute indicates that the "rights and powers" clause is separate and distinct from the avoidance clause. *See Gibson Dunn*, 2007 WL 2669150, at *11 (the "language of section 544(a) supports a finding that trustees are endowed with more than solely avoidance powers"); *In re Sw. Supermarkets, LLC*, 325 B.R. at 426.

In addition to the plain meaning of § 544(a), a review of pre-Code bankruptcy law and legislative history supports this interpretation. Under the predecessor statute to § 544, § 70(c) of the Bankruptcy Act, 11 U.S.C. § 110(c) (repealed), the "rights and powers" of the trustee as a judgment creditor did not include avoidance provisions at all. *See In re Mill Concepts Corp.*, 123 B.R. 938, 940 n.3 (Bankr. D. Mass. 1991) (quoting § 70(c)).

When Congress enacted § 544(a) in 1978, it stated that "[t]he avoiding powers under section 544(a)(1), and (2), and (3) are new." H. R. Rep. No. 95-595, (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6456. Given that the avoidance powers of § 544(a) were new in 1978, and that the "rights and powers" language of the predecessor statute was retained, it is nonsensical to suggest that § 544(a) is limited to avoidance actions.

Were that not enough, Congress expressly stated that it intended § 544(a) to reach causes of action other than avoidance actions. In the legislative history of the enactment of the Bankruptcy Code in 1978, Congress stated that if a debtor partnership's assets are insufficient to pay all claims against the estate, the Uniform Partnership Act gives the debtor a right to compel contribution against the partnership's partners, and noted that "the lien under 11 U.S.C. 544(a) is only on the chose in action, not on the property directly." H. R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6160. Thus, Congress expressly contemplated that a trustee, acting as a judgment creditor, would have a lien on the debtor's cause of action for contribution.

In short, under the statute's plain language, the evolution of the statutory language, and the expressed intent of Congress, § 544(a) is not limited to avoidance actions. To the contrary, the Trustee may, in addition to avoiding transfers of the debtor's property, assume *all* the "rights and powers" of a hypothetical judgment creditor available under state law. *See Zilkha Energy Co. v. Leighton*, 920 F.2d 1520, 1523 (10th Cir. 1990).

The Moving Defendants cite to a single bankruptcy court case, *Goldin v. Primavera Familienstiftung* (*In re Granite Partners, L.P.*), 194 B.R. 318, 324 (Bankr. S.D.N.Y. 1996), as well as to 5 Collier on Bankruptcy ¶ 544.01 (16th ed. 2011), for the proposition that § 544(a) is limited to avoidance actions. (JPMC Br. 11 n.5.) But *Granite Partners* relies exclusively on Collier, and Collier's conclusion (along with the holdings of courts that have followed that conclusion) is contrary to the plain language of the statute and its legislative history, and ignores cases that have reached the opposite conclusion. Further, of the two cases Collier cites for this proposition, one refers back to Collier, and the other grounds its conclusion in the Supreme Court's decision in *Caplin v. Marine Midland Grace Trust Co. of N.Y.*, 406 U.S. 416, 434 (1972). As set forth immediately below, *Caplin* has no relevance to the § 544(a) analysis, because the predecessor to § 544(a), § 70(c) of the Bankruptcy Act, was not in effect when the *Caplin* liquidation commenced, and the Second Circuit's decision in *St. Paul* rejected the notion that *Caplin* limits causes of action asserted under § 544 to only avoidance actions. *St. Paul*, 884 F.2d at 702 n.3.

G. *Caplin* and Its Progeny Do Not Bar Actions by the Trustee as a Hypothetical Judgment Creditor

Those cases that have held that § 544(a) does not reach beyond avoidance actions generally rely on the proposition generally attributed to *Caplin*, 406 U.S. at 434, that a bankruptcy trustee has no standing generally to sue third parties on behalf of the estate's creditors, but may only assert claims held by the bankrupt corporation itself. But *Caplin* was grounded in the precursor to § 541, namely actions brought in which the trustee stands in the shoes of the corporation—asserting claims that the corporation owned at the commencement of the bankruptcy proceeding.

Under § 544, however, the Trustee has express statutory authority to stand in the shoes of a hypothetical judgment creditor, not the debtor. And in 1965, when the liquidation in *Caplin* began, the hypothetical judgment creditor powers did not exist. *See* Vern Countryman, *The Use of State Law in Bankruptcy Cases* (*Part II*), 47 N.Y.U.L. Rev. 631, 650–51 (1972) (prior § 70(c) was deleted in 1950 and not reinserted until 1966); Frank R. Kennedy, *The Bankruptcy Amendments of 1966*, 1 Ga. Law Rev. 149, 167 (1967) (same); *see also* Steven E. Boyce, Koch Refining and In re Ozark: *The Chapter 7 Trustee's Standing to Assert an Alter Ego Cause of Action*, 64 Am. Bankr. L. J. 315, 325, n.66 (1990) (same). Accordingly, the *Caplin* Court could not have considered the implications of hypothetical judgment creditor status on a trustee's ability to bring third-party claims.

In *St. Paul*, the Second Circuit expressly rejected the notion that *Caplin* served to bar all third-party actions by a trustee on behalf of creditors. 884 F.2d at 700-01. *St. Paul* held that a bankruptcy trustee had the exclusive authority to bring a state alter ego tort claim on behalf of creditors against a third party when generalized harm to creditors was asserted. *Id.* at 705. The Second Circuit noted that in a prior opinion, it had written in *dicta* that "'[t]he Trustee in bankruptcy has standing to represent only the interests of the debtor corporation.'" *Id.* at 702 n.3. The correct proposition, the Second Circuit held, is "that causes of action that could be asserted by the debtor are property of the estate and should be asserted by the trustee, *as should causes of action such as those that fall under 11 U.S.C. §§ 544, 547, 548*." *Id.* (emphasis added). Thus, under *St. Paul*, an action under § 544 against a third party may proceed when the action asserts a generalized harm to creditors.

The *Gibson Dunn* court also found *Caplin*'s concerns inapplicable in light of the "Bankruptcy Code's expressed intent to promote equality of distribution among similarly situated creditors." 2007 WL 2669150, at *13 (citing H. R. Rep. No. 95-595, 340, 95th Cong., 1st Sess. (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6297). As the Second Circuit reasoned in *St. Paul*, permitting a trustee to assert generalized creditor claims against third parties "would have the effect of bringing the property of the third party into the debtor's estate, and thus would benefit all creditors." 884 F.2d at 701. So too here.

Certain cases wrongly reason that § 544(a) reaches only avoidance actions because Congress failed to enact proposed § 544(c), a provision that was designed to reverse *Caplin*'s holding, in the 1978 amendments to the Bankruptcy Code. *See, e.g, Mixon v. Anderson* (*In re Ozark Restaurant Equip.*), 816 F.2d 1222, 1227–28 (8th Cir. 1987). But the Second Circuit has rejected any inference from Congress's failure to pass this subsection, holding that "[t]here is no evidence to suggest the grounds on which proposed § 544(c) was actually rejected." *CBI,* 529 F.3d at 458. Absent such evidence, no inferences can be drawn from Congress's refusal to enact § 544(c).

In any event, *Caplin* did not bar creditor claims like those asserted here, which allege generalized harm. Thus, Congress's failure to overrule *Caplin* statutorily has no bearing on those claims. *See Koch Ref.*, 831 F.2d at 1347 n.11 ("the deletion of [§ 544(c)] means only that *Caplin* is not overruled and that there is no express statutory provision allowing a trustee to bring an action which *certain* creditors, like debenture holders, have. The omission does not affect a trustee's right to bring a general action on behalf of all creditors rather than a personal one on behalf of only some.") (emphasis in original); *see also Gibson Dunn*, 2007 WL 2669150, at *11–13.

While the Moving Defendants may argue that Congress did not intend to give authority to trustees beyond avoidance actions, the Moving Defendants have to read the "rights and powers" language out of § 544(a) in doing so.

IV. THE TRUSTEE HAS STANDING AS BAILEE, SUBROGEE, AND ASSIGNEE TO BRING COMMON LAW CLAIMS

A. The Trustee Has Standing as the Bailee of Customer Property

1. The Second Circuit Held in *Redington* that a SIPA Trustee has Standing to Sue as a Bailee and that SIPC Has Standing to Sue as a Subrogee

The Second Circuit in *Redington* held that a SIPA trustee is a bailee of customer property. 592 F.2d at 625. A SIPA trustee is responsible for marshaling and returning customer property, and to the extent he is unable to do so, he may sue on behalf of the customers/bailors any wrongdoer they could sue themselves. 15 U.S.C. § 78fff-1(b); *Redington*, 592 F.2d at 625. To establish standing as a bailee, a SIPA trustee must expressly allege that SIPC has been unable to fully reimburse all customers for all of their losses. *Picard v. Taylor* (*In re Park S. Sec., LLC*), 326 B.R. 505, 517 (S.D.N.Y. 2005). The Trustee has made these allegations in his Amended Complaint, and therefore has standing to bring customer claims against the Moving Defendants as a bailee.

In *Redington*, a SIPA trustee and SIPC filed an action for damages against the debtor's accounting firm based on the auditor's alleged misconduct in auditing the failed broker. 592 F. 2d at 619–20. The trustee and SIPC brought common law claims and claims for violations of § 17(a) of the Securities and Exchange Act of 1934 ("Exchange Act") and the regulations promulgated thereunder. *Id.* at 620.

In reversing the district court's dismissal of the § 17(a) claims, the Second Circuit held that a SIPA trustee, as bailee, has standing to sue third-party wrongdoers to the extent the trustee is unable to satisfy customers' net equity claims. *Id.* at 625. The court also held that SIPC can sue as the equitable subrogee of customers to whom it made advances to cover their losses of customer property. *Id.* at 624. The Second Circuit further held that § 17(a) provides a private right of action to customers of a broker dealer, and that the SIPA trustee and SIPC could bring those claims—for harm to customer property—as bailee and subrogee, respectively. *Id.* at 623–25.

While the Supreme Court subsequently reversed the Second Circuit's determination that § 17(a) created a private right of action, *Redington*, 442 U.S. at 579, the Supreme Court left undisturbed the Second Circuit's holdings that a SIPA trustee has standing as bailee of the fund of customer property, and that SIPC has standing as subrogee, to pursue claims against third parties. *Id.* at 567 n.9.

2. *Redington* Remains the Law of This Circuit

a. *Redington's* Standing Determination is Binding Precent

It is well settled that a holding of the Second Circuit is binding unless it is overruled expressly or impliedly by an *en banc* decision of the Second Circuit or the Supreme Court. *See BankBoston, N.A. v. Sokolowski* (*In re Sokolowski*), 205 F.3d 532, 534–35 (2d Cir. 2000). The Second Circuit's standing determinations in *Redington* remain the law of the Circuit, as neither an *en banc* panel of the Circuit, nor the Supreme Court, has questioned them, much less overruled them. Indeed, in the only Second Circuit case to touch on *Redington*'s standing determinations, the Circuit noted the binding nature of those determinations, quoting *Sokolowski. SIPC v. BDO Seidman, LLP*, 222 F.3d 63, 69 (2d Cir. 2000) (quoting 205 F.3d at 534–35).

In *BDO Seidman*, a SIPA trustee and SIPC brought an action seeking damages against the broker-dealer's accountant for various state law causes of action. *SIPC v. BDO Seidman,* LLP, 49 F. Supp. 2d 644, 646 (S.D.N.Y. 1999). Chief Judge Preska found that, *inter alia*, the

SIPA trustee had standing to bring suit on behalf of the broker-dealer's customers as a bailee. *Id.* at 654. In so holding, Chief Judge Preska reasoned that "[w]hen the Supreme Court reversed the Court of Appeals, it did not disturb" the Second Circuit's holding that a SIPA trustee could assert claims on behalf of customers who were not fully reimbursed by SIPC as bailee of customer property. *Id.* at 652. Chief Judge Preska found she was "bound by *Redington* to hold that the Trustee can bring suit as bailee." *Id.* at 654. On appeal, when discussing whether it would be justified in revisiting *Redington*, the Second Circuit acknowledged that "[t]his court is bound by a decision of a prior panel unless and until its rationale is overruled, implicitly or expressly, by the Supreme Court or this court *en banc*." *BDO Seidman*, 222 F.3d at 69 (quoting *Sokolowski*, 205 F.3d at 534–35).

The Moving Defendants contend, citing to *HSBC*, that *Redington* is no longer binding authority, arguing that because the Supreme Court held that there was no private right of action under § 17(a), the Court effectively "held that the Second Circuit erred in reaching the issue of whether the SIPA trustee had implied standing to bring" a claim under that section. (JPMC Br. 14.)

This is an incorrect proposition of law. A trustee's standing is a question of subject-matter jurisdiction—whether the trustee has been injured such that a "case or controversy" exists. *Breeden v. Kirkpatrick & Lockhart LLP* (*In re Bennett Funding Grp., Inc.*), 336 F.3d 94, 101–02 (2d Cir. 2003); *see also Nnebe v. Daus*, 644 F.3d 147, 156 (2d Cir. 2011) ("Standing is the threshold question in every federal case, determining the power of the court to entertain the suit.") (internal quotations omitted). A court always has jurisdiction to determine its jurisdiction. *See Rhodes-Bradford v. Keisler*, 507 F.3d 77, 81 (2d Cir. 2007) ("It is, of course, the case that we have jurisdiction to determine whether or not we have jurisdiction over a matter."). Thus, the

Second Circuit in *Redington* had jurisdiction to decide the standing decisions when it did. The fact that the Supreme Court ultimately determined that the particular cause of action asserted under § 17(a) was not available—a merits question, not a jurisdictional one—has no bearing on the preliminary jurisdictional standing determination. *See Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869, 2877 (2010) (noting the scope of § 10(b) of the Securities and Exchange Act is a merits question, not one of subject matter jurisdiction).

Nor did the Second Circuit's decision on remand affect its original holding on standing. The Second Circuit had subject matter jurisdiction to determine whether the SIPA trustee had Article III standing. On remand, this jurisdictional question was not before the court, having already been settled, and the purported federal claim had been determined on the merits not to be viable. The court proceeded to the remaining jurisdictional issues, and, finding no diversity and that there was no longer a federal claim for relief, it dismissed the remaining state law claims, effectively refusing to retain pendent jurisdiction over them. *Redington v. Touche Ross & Co.*, 612 F.2d 68, 70 (2d Cir. 1979).

The Moving Defendants rely on *Newdow v. Rio Linda Union School District*, 597 F.3d 1007, 1041 (9th Cir. 2010), to advance their theory that *Redington* is no longer good law. (JPMC Br. 15.) *Newdow* stands for the proposition that when the Supreme Court reverses a lower court's decision on the threshold question of lack of jurisdiction, the merits determinations are not precedential. *Id.* That is because "a district court must generally resolve material factual disputes and establish that it has federal constitutional jurisdiction, including a determination that the plaintiff has Article III standing, before deciding a case on the merits." *Alliance for Envtl. Renewal, Inc. v. Pyramid Crossgates Co.*, 436 F.3d 82, 85 (2d Cir. 2006) (internal citations omitted). But in *Redington*, the Supreme Court's reversal was on the merits; the question of standing, itself jurisdictional, was not affected.

The Supreme Court's reversal of a decision on one ground does not negate the precedential effect of a lower court opinion in other respects. For example, in *Best Van Lines, Inc. v. Walker*, 490 F.3d 239, 247 n.10 (2d Cir. 2007), the Second Circuit cited as precedential authority its holding in *Padilla v. Rumsfeld*, 352 F.3d 695, 709 (2d Cir. 2003), *rev'd on other grounds*, 542 U.S. 426 (2004), for *Padilla*'s interpretation of the New York long-arm personal jurisdiction statute, despite the fact that the Supreme Court held, when reversing *Padilla*, that Padilla could be sued only in the jurisdiction of his confinement, not New York. *Padilla*, 542 U.S. at 496. Similarly, in *Wickham Contracting Co. v. Local Union No. 3, International Brotherhood of Electrical Workers, AFL-CIO*, 955 F.2d 831, 835 (2d Cir. 1992), the Second Circuit cited as precedential authority its holding in *Trans World Airlines, Inc. v. Hughes*, 449 F.2d 51, 80 (2d Cir. 1971), *rev'd on other grounds*, 409 U.S. 363 (1973), for the proposition that prejudgment interest is not available in antitrust cases where treble damages are awarded, despite the fact that the Supreme Court held, when reversing *Trans World Airlines*, that the defendant had immunity under the antitrust laws. *Trans World Airlines*, 409 U.S. at 386, 388–89. In both *Best Van Lines* and *Wickham*, the Second Circuit cited as binding precedent propositions of law set forth in prior cases that were reversed on other grounds, even though the propositions for which they were cited would never have been reached had the Second Circuit decided a preliminary issue in the manner in which the Supreme Court did.[6]

It is only when a judgment is vacated, as opposed to when it is reversed on other grounds, that the decision below lacks precedential effect. *See Brown v. Kelly*, 609 F.3d 467, 476–77 (2d Cir. 2010) ("A decision may be *reversed* on other grounds, but a decision that has been *vacated* has no precedential authority whatsoever.") (emphasis in original) (quoting *Durning v. Citibank, N.A.*, 950 F.2d 1419, 1424 n.2 (9th Cir. 1991)); *Cnt. Pines Land Co. v. United States*, 274 F.3d 881, 894 n.57 (5th Cir. 2001) ("While our prior opinion in *Leiter Minerals II* did not bind the *Little Lake* panel because it was *vacated*, the opinion in *Little Lake* binds us because only the *judgment* was reversed on other grounds.") (emphasis in original). Here, the Supreme Court did not vacate the Second Circuit's judgment. *Redington*, 442 U.S. at 579. Rather, the Supreme Court reversed on other grounds, without reaching the Second Circuit's separate holding that a SIPA trustee and SIPC have standing to bring causes of action as bailee and subrogee, respectively. *See id*. at 578–79.

Mishkin and *HSBC* improperly ignore *BDO Seidman* and the precedential value of *Redington*. The Supreme Court's decision did not "wipe[] out everything that . . . occurred up to that time." (JPMC Br. 16–17) (citing *Mishkin* transcript and *HSBC*, 2011 WL 3200298, at *7–8.) The precedential value of the *Redington* decision remains intact, and *Mishkin* and *HSBC* are

[6] To counter this argument, the Moving Defendants rely on *Brecht v. Abrahamson*, 944 F.2d 1363, 1370 (7th Cir. 1991). But *Brecht* is inconsistent with how the Seventh Circuit generally treats the precedential value of its own decisions that have been reversed on other grounds—namely, just as the Second Circuit does. For example, in *Muscarello v. Ogle County Board of Commissioners*, 610 F.3d 416, 426 (7th Cir. 2010), decided well after *Brecht*, the Seventh Circuit cited *Littleton v. Berbling*, 468 F.2d 389, 394 (7th Cir. 1972), *rev'd on other grounds, O'Shea v. Littleton,* 414 U.S. 488 (1974), to describe the scope of a court's discretion not to dismiss a matter for lack of subject matter jurisdiction when jurisdiction exists but is not properly pleaded—even though the Supreme Court in *Littleton* ultimately held that subject matter jurisdiction did not exist in that case.

outliers. The Sixth Circuit remarked that *Mishkin* "departed from the precedent of its circuit." *Appleton v. First Nat'l Bank of Ohio*, 62 F.3d 791, 799–800 (6th Cir. 1995).

b. The *HSBC* Court's Rationales for Why Redington Lacks Precedential Effect Are Unavailing

The Trustee respectfully disagrees with the reasoning in the *HSBC* decision as to why *Redington* may be ignored.

First, *HSBC* distinguished *Morrison* on the ground that it involved a determination of the scope of the Securities and Exchange Act, which is a merits question, stating that *Morrison* "concerned whether an accepted cause of action brought under § 10(b) was properly pled, not whether a right of action existed at all." (*HSBC*, 2011 WL 3200298, at *11 n.7.) Justice Scalia, however, expressly stated that the Supreme Court granted *certiorari* to decide "whether §10(b) of the Securities Exchange Act of 1934 *provides a cause of action* to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign exchanges." *Morrison*, 103 S. Ct. at 2875 (emphasis added).

Second, the language quoted from *National Railroad Passenger Corp.* in *HSBC* does not stand for the proposition that standing never can be considered and decided as a separate threshold issue apart from the existence of a particular right of action. *See HSBC*, 2011 WL 3200298, at *11 n.7 ("'[it is only if such a [private] right of action exists that we need consider whether the respondent had standing . . .'") (alterations in original). In *National Railroad*, the Supreme Court noted that whether a private right of action was created by the Amtrak Act and whether the respondent had standing to bring it were in that case virtually the same question, or at least, inextricably overlapping. *Nat'l R.R. Passenger Corp. v. Nat'l Ass'n of R.R. Passengers*, 414 U.S. 453, 456–57 (1974). That is not the case here. *Redington* held that the SIPA trustee can sue any wrongdoer whom the customers could sue themselves for any cause of action that the customers could bring themselves. *Redington*, 592 F.2d at 625. This question is different from that of whether the particular claim asserted by the trustee in that action exists. The Second Circuit addressed the question of whether the SIPA trustee is a bailee of customer property and whether SIPC is a subrogee before—and independently of—whether § 17 created a private right of action.

3. The Trustee Is the Representative of the Fund of Customer Property

a. The Bailment Is Created by Operation of Law

The Trustee brings the common law claims against the Moving Defendants "as representative of, and as bailee of, the Customer Property estate." (Am. Compl. ¶ 15(f).) Consistent with *Redington*, this status may be viewed as a bailment relationship arising by operation of law. *See Seaboard Sand & Gravel Corp. v. Moran Towing Corp.*, 154 F.2d 399 (2d Cir. 1946); *Fada Indus. v. Falchi Bldg. Co., L.P.*, 730 N.Y.S.2d 827 (N.Y. Sup. Ct. 2001).

The fundamental elements of a bailment are (1) "lawful possession, however created," and (2) the "duty to account for the thing as the property of another. . . ." *Foulke v. N.Y. Consolidated R.R. Co.*, 228 N.Y. 269, 275 (1920). SIPA thus creates this relationship by entrusting the fund of customer property to the SIPA trustee and bestowing upon him the duty to marshal and return such property to the customers. Based on his lawful possession, a bailee has a special property interest—a possessory interest—in the bailment that, under the law of bailment, is sufficient to give the bailee the right to sue third parties for damage or loss caused to the property. *Paragon Oil Co. v. Republic Tankers, S.A.*, 310 F.2d 169, 175 (2d Cir. 1962). The Second Circuit's decision in *Redington* is thus rooted in SIPA and its creation of a relationship between a SIPA trustee and the fund of customer property, as well as in the law of bailment, which describes the rights and powers of the SIPA trustee by virtue of that relationship.

This bailment exists independently of the Trustee's other capacity as representative of, or successor to, BLMIS. Rather, the bailment is predicated on the Trustee's exclusive possession of the fund of customer property and his status as representative of the separate customer property estate pursuant to SIPA. *See In re BLMIS*, 2011 WL 3568936, at *3 ("In a SIPA Liquidation, a fund of 'customer property,' separate from the general estate of the failed broker-dealer, is established. . . ."); *Rosenman Family, LLC v. Picard*, 395 F. App'x 766, 768 (2d Cir. 2010) (explaining that the "customer property estate . . . is separate from the general estate used to satisfy the claims of general unsecured creditors").

Thus, SIPA trustees wear two hats, vindicating the interests of two separate estates—the general estate (as a bankruptcy trustee) and the customer property estate. "Generally, SIPA liquidations involve two kinds of claimants: customers and general unsecured creditors. To protect customers of failed brokerages, their claims are satisfied from a customer property estate, which is separate from the general estate used to satisfy the claims of general unsecured creditors." *Rosenman*, 395 Fed. App'x at 768 (citing *In re Adler Coleman Clearing Corp.*, 195 B.R. 266, 270 (Bankr. S.D.N.Y. 1996)).

The Moving Defendants argue that the absence of the term "bailment" on the face of the statute proves *ipse dixit* that SIPA does not create a bailment relationship. (JPMC Br. 14.) This argument is unavailing. A bailment is a way to characterize a relationship between two parties. The word "bailment" also does not appear on the claims ticket when one checks one's clothes at the dry cleaner. However, the law describes the rights and duties of parties that stand in relationships to one another; the absence of the word does not change the nature of the relationship SIPA creates between the Trustee and the fund of customer property.

b. The *HSBC* Court's Distinctions Concerning the Bailment Relationship Are Mistaken

The Moving Defendants contend, and the *HSBC* court reasoned, that because Madoff, as a thief, could never be a bailee, the Trustee as his successor-in-interest, cannot be a bailee. (JPMC Br. 17;) *HSBC*, 2011 WL 3200298, at *5. However, the Trustee's capacity as representative of the fund of customer property is unaffected by any intention of Madoff to misappropriate funds deposited by investors in BLMIS. This relationship is not created between the customers and BLMIS (or by any agreement), but by operation of SIPA—by entrusting the separate fund of customer property to the Trustee's care for return to the customers.[7] *See Seaboard Sand & Gravel*, 154 F.2d at 402; *Fada Indus.*, 730 N.Y.S.2d at 839–40. This relationship is a bailment created by law, a form of trust, which arises from the situation in which SIPA places the parties. It is, in turn, the Trustee's lawful possessory interest that provides the basis for the Trustee's right to sue the Moving Defendants for damages.

Moreover, in *HSBC*, the court stated that "the purported breach is alleged to have occurred prior to the bailment, since the [defendants] are alleged to have poured money into Madoff Securities." *HSBC*, 2011 WL 3200298, at *8. This reasoning misses the fundamental point that it is the Trustee who is entrusted with the fund of customer property by SIPA. He does not acquire it through succession to BLMIS, nor does his status depend on BLMIS's relationship to its customers or to customer property. Moreover, under the SIPA scheme, the Trustee's status as representative of the fund of customer property is explicitly retroactive in scope. SIPA anticipates the fraudulent activities of agents such as Madoff, by defining customer property to include cash "at any time received," including property "unlawfully converted." 15 U.S.C. §

[7] SIPC argues in its brief that the bailment can alternatively be viewed as a creature of federal common law.

78*lll*(4). SIPA itself is thus predicated on the fundamental principle that the customers of a broker-dealer never lose ownership of customer property, regardless of whether it is improperly commingled or converted while in the hands of the broker-dealer. The fund of customer property, and the Trustee's role as representative, necessarily look back at the events and circumstances that led to the failure of the broker-dealer, in order to maximize customer property and vindicate his interest in the fund.

The *HSBC* Court also stated that the Trustee is not a bailee because "he is not seeking to 'return any recovered bailments to the individual bailors,' as a bailee would, but instead is seeking to distribute customer property pro rata pursuant to the SIPA distribution scheme." *HSBC Bank*, 2011 WL 3200298, at *5. However, the Trustee is seeking to do precisely what a bailee would do in these circumstances: recover damages for harm to the property, which he holds in trust for the benefit of the bailors. *See Rogers v. Atlantic, Gulf & Pac. Co.*, 213 N.Y. 246, 258 (1915).

The Trustee submits that *HSBC*'s observation that *Redington* dealt with a trustee's and SIPC's right to bring claims under § 17 of the Exchange Act, as opposed to common law claims, is a distinction without a difference. The Court in *Redington* held that the SIPA trustee could sue "any wrongdoer whom [the customers] could sue themselves." *BDO Seidman*, 222 F.3d at 71 (quoting *Redington*, 592 F.2d at 625). Under the law of bailment, the bailee's possessory interest entitles him to bring any claim for damage or loss to the bailed property. There is no rationale for the conclusion that *Redington* somehow limited the trustee's standing as bailee to claims under § 17 of the Exchange Act. *HSBC* noted that common law claims differ from federal statutory claims in that they "generally require proof of individual reliance and causation, which may pose justiciability concerns in the context of a mass tort action by a SIPA trustee." *HSBC*, 2011 WL 3200298, at *8. However, there seems little basis for distinguishing the "justiciability" of common law claims—by which the *HSBC* court seems to have meant their ability to be fairly and efficiently adjudicated *en masse*—from claims under § 17 of the Exchange Act, especially because as bailee, the SIPA trustee sues for harm to customer property in both instances. Nor does the manner in which claims will be adjudicated have anything to do with standing.

The *HSBC* court's statement that *Redington* was more analogous to "a traditional bailor-bailee scenario" ignores *Redington's* reliance on a trustee's duty to marshal and return customer property under SIPA. *HSBC*, 2011 WL 3200298, at *8; *see also Redington*, 592 F.2d at 625. In *Redington*, the court described the relationship between the SIPA trustee and customer property and the powers of the trustee that arise from that relationship. Insofar as the SIPA trustee's traditional bailor-bailee scenario is concerned, *Redington* determined that this legal doctrine of bailment appropriately should be applied in the context of a SIPA trustee.

c. As Bailee and Representative of the Fund of Customer Property, the Trustee Can Recover Damages for the Benefit of the Fund

SIPA contemplates that a trustee may recover damages. First, customer property includes not only property fraudulently transferred but also "the proceeds of any such property transferred by the debtor, including property unlawfully converted." 15 U.S.C. § 78*lll*(4). Given a broad reading of SIPA, damages caused by the Moving Defendants' participation in perpetuating the Ponzi scheme are reasonably subsumed within the concept of "proceeds" of "unlawfully converted" property. Moreover, SIPA expressly contemplates that a trustee may recover more in the customer property estate than is needed to satisfy customers' net equity claims, belying the notion that actions to recover customer property are limited to seeking amounts fraudulently transferred. *See* 15 U.S.C. § 78fff-2(c) ("Any customer property remaining after allocation in accordance with this paragraph shall become part of the general estate of the debtor.").

It would be impossible to predict *ex ante* whether avoidance actions alone would recover funds necessary to satisfy customers' net equity claims. Accordingly, the trustee must have additional authority to pursue claims beyond the quantum of avoidable transfer claims to augment the customer property estate and the court should construe the statute liberally to accomplish its purpose.[8]

B. The Trustee Has Standing to Assert SIPC's Subrogation Rights Arising From SIPC Advances

The Trustee also has standing to assert subrogation claims belonging to SIPC, through SIPC's assignment of its subrogation rights to the Trustee.

1. The Trustee's Subrogation Rights Stem From Equity and SIPA

Under the law of equitable subrogation, where one party (SIPC) discharges an obligation owed by another (BLMIS), such that the latter would be unjustly enriched by the retention of the benefit thus conferred, the former is subrogated to the position of the person to whom the obligation is owed (BLMIS's customers). *Elwood v. Hoffman*, 61 A.D.3d 1073, 1075 (3rd Dep't 2009). Courts favor the application of subrogation, and have extended rather than restricted its application. *3105 Grand Corp. v. City of N.Y.*, 288 N.Y. 178, 182 (1942); *Menorah Nursing Home, Inc. v. Zukov*, 153 A.D.2d 13, 18 (2d Dep't 1989). The Second Circuit held that SIPC has equitable subrogation rights. *See Redington*, 592 F.2d at 624. The court ruled that its holding was "more keeping with the intent of Congress that wrongdoers not receive a windfall benefit

[8] This Court is empowered to exercise its discretion under prudential standing to allow the Trustee to proceed. Prudential theories of standing are judicially created and so long as a litigant has been found to have Article III standing—which the Trustee does—it is within the court's discretion to decide whether to apply prudential limitations on standing to a particular case. *See United Food & Commercial Workers Union Local 751 v. Brown Grp., Inc.*, 517 U.S. 544, 551 (1996).

from the existence of SIPC, and that SIPC be able to recoup its losses from solvent wrongdoers." *Id.*

SIPC's subrogation rights stem not only from equity, but from the statute itself. While the version of SIPA at play in *Redington* did not contain statutory provisions that included subrogation rights as against third parties, significantly, the statute was later amended. When *Redington* was decided, then-SIPA § 78fff(A)(1) *expressly* limited SIPC's subrogation rights to "customers' claims against the debtor's . . . estate." *Id.*; *see* Act of May 21, 1978, Pub. L. 95–283 § 8, 92 Stat. 249 (codified at 15 U.S.C. § 78aaa, *et seq.*). After *Redington*, however, Congress replaced that section of the statute with § 78fff-3(a), which does not contain this limitation. Section 78fff-3(a) states, in relevant part:

> To the extent moneys are advanced by SIPC to the trustee to pay or otherwise satisfy the claims of customers, in addition to all other rights it may have at law or in equity, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this chapter, except that SIPC as subrogee may assert no claim against customer property until after the allocation thereof to customers as provided in section 78fff–2(c) of this title.

15 U.S.C. § 78fff-3(a). The removal of the express limiting language indicates Congress's intent to expand SIPC's subrogation rights.

Thus far, the Trustee has distributed approximately $800 million to customers from funds advanced to him by SIPC. In advancing these funds, SIPC has retained subrogation rights to pursue those responsible for the amount it spent to compensate customers for their losses. As a subrogee, SIPC has the right to assert claims against third parties in place of those customers to whom SIPC has advanced funds. *See Redington*, 592 F.2d at 624; *see also BDO Seidman*, 222 F.3d at 69; *Picard v. Taylor (In re Park S., LLC)*, 326 B.R. 505, 515–16 (Bankr. S.D.N.Y. 2005); *Giddens v. D.H. Blair & Co.* (*In re A.R. Baron & Co.*), 280 B.R. 794, 805 (Bankr. S.D.N.Y. 2002). SIPC has conferred its subrogation rights onto the Trustee and, thus, the Trustee has standing to assert the common law claims against the Moving Defendants as a subrogee. (*See* Am. Compl. ¶ 15(h)); *see also In re Park S.*, 326 B.R. at 515–16.

2. *HSBC* Incorrectly Held That the Trustee Lacked Standing on the Basis of Subrogation

The Moving Defendants rely on *Mishkin v. Peat, Marwick, Mitchell & Co.*, 744 F. Supp. 531 (S.D.N.Y. 1990), and *HSBC*, both of which ignore binding Second Circuit precedent and misapply the law of subrogation. (JPMC Br. 19–21.) The Court in *Mishkin* disagreed with the Second Circuit's analysis that SIPC advances could create rights of equitable subrogation because SIPA "was not intended to be an insurance-type statute" and "application of insurance principles of subrogation is seemingly inappropriate." 744 F. Supp. at 557–58. This holding misconceives the statute; subrogation is a doctrine of equity and is not limited to "insurance principles." *See, e.g., Perez v. Fiore*, 912 N.Y.S.2d 118, 120 (2d Dep't 2010) (citing *Gerseta Corp. v. Equitable Trust Co. of N.Y.*, 241 N.Y. 418, 425–26 (1926) (applying equitable subrogation outside of insurance context)); *Gerow v. Sinay*, 905 N.Y.S.2d 827, 833–34 (Sup. Ct. Onondaga County 2010) (citing *King v. Pelkofski*, 20 N.Y.2d 326, 333–34 (1967)). Subrogation rights exist under long-recognized equitable principles and can be circumscribed by statute only if done expressly. *See, e.g., Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 541–42 (2001) (holding that federal preemption of state law rights must be "clear and manifest"). SIPA does not circumscribe SIPC's equitable subrogation rights. In fact, it does precisely the opposite; in granting to SIPC *statutory* subrogation rights, it expressly provides that such rights are "in addition to all other rights it may have at law or in equity." 15 U.S.C. § 78fff-3(a).

HSBC held that SIPC cannot be equitably subrogated to customers' claims against third parties because that right would subvert SIPA's distribution scheme, as SIPC would recover before customers. *HSBC*, 2011 WL 3200298, at *6. *HSBC* is incorrect and contrary to the basic principle that equitable subrogation is not to be restricted in its application. *See, e.g., 3105 Grand Corp.*, 42 N.E.2d at 477. SIPC's right arises as a matter of equity, because it was required to pay obligations that were owed in part by third-party wrongdoers. It is unreasonable to read SIPA's distribution scheme as "conflicting" with SIPC's equitable right. Instead, the two should be harmonized to the extent possible, with SIPA simply modifying the timing and mechanics of SIPC's recovery to the extent necessary. *See Bates v. Dow Agrosciences LLC*, 544 U.S. 431, 449 (2005) (holding that when a statute is susceptible to more than one plausible reading, the court has "a duty to accept the reading that disfavors pre-emption").[9]

C. The Trustee Has Standing to Bring Claims Assigned to Him by BLMIS Customers

The Trustee has not yet received assignments from any customers. (*See* Am. Compl. ¶ 15.) Thus, while this issue may not yet be ripe for adjudication, because the Moving Defendants have raised the issue, the Trustee addresses it.

1. The Second Circuit Held in *CBI* That Creditors Can Assign Causes of Action to a Bankruptcy Trustee

In *CBI*, the Second Circuit held that an appointed disbursing agent for the debtor's reorganization plan had standing to assert assigned claims. The Second Circuit reasoned that "[a]llowing a debtor's creditors to assign their claims for the benefit of the debtor's estate permits debtors, creditors, and bankruptcy courts the flexibility in reorganizing or liquidating a debtor's assets necessary to achieve efficient administration of the reorganization or liquidation." *529 F.3d at 459. CBI* held that a bankruptcy trustee's power to take assignments stems from § 541(a)(7) of the Bankruptcy Code. *Id.* At 456-59.

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[9] Moreover, there is no conflict with SIPA's provision allocating customer property. 15 U.S.C. §78fff-2(c)(1). As equitable subrogee, to the extent of its advances, SIPC is subrogated to customers' claims against third party wrongdoers and is entitled to recover in that capacity.

Numerous other courts have reached the same conclusion. *See, e.g.*, *Semi-Tech Litig.*, 272 F. Supp. 2d at 323–24; *Bogdan v. JKV Real Estate Servs.* (*In re Bogdan*), 414 F.3d 507, 511–12 (4th Cir. 2005). In determining that a bankruptcy trustee had standing to assert common law claims against the debtor's co-conspirators as the assignee of certain creditors' claims, the Fourth Circuit in *Bogdan* explained a trustee's authority to bring these claims:

> The trustee is specifically authorized to "collect and reduce to money *the property of the estate* for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest." . . . "*[P]roperty of the estate" under § 541(a) has "uniformly been interpreted to include causes of action."* . . . [and, under § 541(a)(7)] also includes "any interest in property that the estate acquires after the commencement" of a bankruptcy case. Thus, the unconditional assignments acquired by [the] trustee from the [debtor's creditors] after commencement of this bankruptcy case constitute "property of the estate" that the trustee is authorized to "collect and reduce to money" on behalf of the estate." . . . *Accordingly, the trustee has the requisite standing to sue [the debtor's] alleged coconspirators "to collect and reduce to money" the causes of action he acquired* . . . .

In re Bogdan, 414 F.3d at 512 (emphasis added) (internal citations omitted).

Significantly, the portion of the Bankruptcy Code—§ 541(a)(7)—that empowers bankruptcy trustees to take assignments is expressly incorporated into the SIPA statute. 15 U.S.C. § 78fff(b). The SIPA statute need not explicitly provide for a power where the power is incorporated through the Bankruptcy Code. *BDO Seidman*, 222 F.3d at 69.

2. The Moving Defendants Ignore *CBI*

Ignoring the Second Circuit's decision in *CBI*, the Moving Defendants cite to district court cases that preceded that decision and, accordingly, never considered a SIPA trustee's standing under § 541(a)(7). (*See* JPMC Br. 22; *HSBC*, 2011 WL 3200298, at *9.) The cases the Moving Defendants cite only analyze a trustee's standing under SIPA. *See In re Park S.*, 326 B.R. at 515 (relying solely on the SIPA statute to determine a trustee did not have standing to bring customer claims against third parties); *BDO Seidman*, 49 F. Supp. 2d at 654 n.7 (declining to construe SIPA "so broadly as to permit standing" to bring suit against third parties as a result of assignments); *Giddens v. D.H. Blair & Co. (In re A.R. Baron & Co.)*, 280 B.R. 794, 802–03 (Bankr. S.D.N.Y. 2002) (limiting claims that customers can assign to a trustee to only the customers' net equity claims and not claims against the defendants); *Mishkin*, 744 F. Supp. at 554–55 (finding that SIPA did not empower the trustee to accept assignments from financial institutions).

Under *CBI*, the Trustee possesses the same abilities as a typical bankruptcy trustee to bring claims as an assignee. *See* 529 F.3d at 459.

V. *WAGONER* AND *IN PARI DELICTO* ARE INAPPLICABLE TO THE TRUSTEE'S CLAIMS

The *Wagoner* Rule and the doctrine of *in pari delicto* do not apply to the Trustee's claims against the Moving Defendants. *Wagoner* and its progeny were cases brought under § 541, and emanate from the principle that a trustee's powers under § 541 are no greater than those of the debtor that preceded it, so that if a malfeasant debtor could not proceed against a third party under the principle of *in pari delicto*, neither could the trustee. *See Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114, 118 (2d Cir. 1991). The *in pari delicto* defense is based on the principle that a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing. *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306 (1985).[10]

A. *In Pari Delicto* and The *Wagoner* Rule Do Not Apply to the Trustee's Contribution Claim

The Moving Defendants' argument that the Trustee's contribution claim is barred under *in pari delicto* and the *Wagoner* rule has no merit. (JPMC Br. 65 n.13.) Parties seeking contribution are necessarily *in pari delicto*. *See HSBC*, 2011 WL 3200298, at *10; *Barrett v. United States*, 853 F.2d 124, 128 n.3 (2d Cir. 1988); *Rotter v. Leahy*, 93 F. Supp. 2d 487, 496 (S.D.N.Y. 2000). Accordingly, the Trustee's contribution claim cannot be blocked by *in pari delicto* and the *Wagoner* rule.

B. Neither *Wagoner* nor *In Pari Delicto* Bars the Trustee's Claims Brought Under § 544

When the Trustee exercises his rights under § 544(a), he stands in the shoes of a hypothetical judgment creditor "without regard to any knowledge of the trustee or any creditor."[11] Accordingly, when actions are brought under § 544, *in pari delicto* does not apply. This principle holds true even when the judgment creditor has appropriated a debtor's cause of action which might otherwise be barred by *in pari delicto*, because § 544(a) provides a Trustee with federal statutory standing as an innocent creditor. *See In re Flanagan*, 373 B.R. 216, 229–

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[10] *In pari delicto* is an equitable affirmative defense under New York law, and should not be considered on a motion to dismiss for lack of standing. *See Kirschner v. KPMG LLP*, 938 N.E.2d 941, 950 (N.Y. 2010). The Court in *Wagoner* applied *in pari delicto* principles in holding that the trustee lacked standing to sue third parties, but this was not well-founded in New York law, which should have governed the issue. *See Buchwald v. Renco Grp., Inc. (In re Magnesium Corp. at Am.)*, 399 B.R. 722, 763 (Bankr. S.D.N.Y. 2009) (recognizing "state law underpinnings" of *Wagoner* "are thin") (citing *Barnes v. Schatzkin*, 212 N.Y.S. 536 (1st Dep't 1925), *aff'd,* 242 N.Y. 555. *Barnes*, the New York case upon which *Wagoner* relied, focused on the identity of the injured party, whether creditor or estate, and does not support transforming *in pari delicto* into a question of standing. *In re Magnesium*, 399 B.R. at 763 nn.137, 139.

[11] *See CBI*, 529 F.3d at 456 ("*Wagoner* specifically leaves open the question of when a bankruptcy trustee can assert claims on behalf of a debtor's creditors.").

30 (D. Conn. 2007) (trustee's successor-in-interest's alter ego and constructive trust claims, barred by *in pari delicto* if brought under § 541, not barred by *in pari delicto* if brought under § 544(a)); *Gibson Dunn*, 2007 WL 2669150, at *15 ("wrongdoing of the debtor is not imputed to the trustee when acting in his capacity as a representative of creditors under § 544(a)"); *Sender v. Mann*, 423 F. Supp. 2d at 1174 ("[*In pari delicto*] applies to claims a bankruptcy trustee brings as a debtor, but not as a representative of creditors, since creditors are not culpable for the misconduct of the corporate entity. This doctrine therefore does not bar [trustee's] claims brought on behalf of creditors, either by assignment or under the authority of § 544(a)."); *Porter McLeod*, 231 B.R. at 794 ("[I]n bankruptcy, [*in pari delicto*] applies only to the trustee in his 'debtor' status, not as 'creditor.'"). *See also MacMenamin's Grill Ltd.*, 450 B.R. at 431 (*Wagoner* Rule and *in pari delicto* do not apply to a trustee "who has independent standing under section 544"); *Podell & Podell v. Feldman* (*In re Leasing Consultants Inc.*), 592 F.2d 103, 110–11 (2d Cir. 1979) (allowing trustee to pursue claims on behalf of creditors under § 544's predecessor "does not undercut the purpose of the doctrine of *in pari delicto*"); *In re Park S. Sec., LLC*, 326 B.R. 505, 515 (Bankr. S.D.N.Y. 2005) ("given such statutory standing, such a claim [for unjust enrichment] would not be subject to any aspect of the *Wagoner* Rule"); *Tolz v. Proskauer Rose LLP* (*In re Fuzion Tech. Grp., Inc.*), 332 B.R. 225, 232 (Bankr. S.D. Fla. 2005) ("courts have found that the *in pari delicto* defense is inapplicable when a trustee brings an action under §§ 544(a), 544(b), or 548, but the defense applies under § 541"); *C-T of Va., Inc. v. Painewebber, Inc.* (*In re C-T of Va., Inc.*), No. 90-1557, 1991 WL 138489, *6 (4th Cir. July 30, 1991) (malfeasance of debtor does not limit right of creditors in avoidance actions under § 544); *Wedtech Corp. v. Nofziger* (*In re Wedtech*), 88 B.R. 619, 622 (Bankr. S.D.N.Y. 1988) ("a trustee's ability to obtain a recovery for an estate and its blameless creditors may not be denied

by the pre-petition wrongful conduct of the debtor"); *Gower v. Farmers Home Admin.* (*In re Davis*), 785 F.2d 926, 927 (11th Cir. 1986) ("[s]ince the trustee's claims are for the benefit of the creditors, the fraud of the bankrupt does not require them to be forfeited"); *Faircloth v. Paul* (*In re Int'l Gold Bullion Exch., Inc.)*, 60 B.R. 261, 264 (Bankr. S.D. Fla. 1986) (trustee's "strong arm" powers not forfeited because of the debtor's fraud); *Hassett v. McColley* (*In re O.P.M. Leasing Serv., Inc.*), 28 B.R. 740, 760–61 (Bankr. S.D.N.Y. 1983) ("trustee's right to recover payments made by the debtor not barred by prepetition wrongful conduct of the debtor").[12]

Moreover, under New York law, a trustee standing in the shoes of a creditor may assert claims that the debtor would otherwise be precluded from bringing. *See Pittsburgh Carbon Co. v. McMillin*, 119 N.Y. 46, 53 (1890) (trustee of insolvent company, acting on behalf of creditors, may "disaffirm dealings of the corporation in fraud of the creditor's rights"); *Cent. Hanover*, 105 F.2d at 131–32 (L. Hand, J.) ("there are occasions when [a trustee] may represent creditors when the defendant would have had no standing") (citing *Pittsburgh Carbon*, 119 N.Y. at 53). "[I]t would be a very strange application of the [*in pari delicto*] doctrine that no right of action can spring from an illegal transaction, which should deny to innocent creditors of the combination, or to the receiver who represents them, the right to have the debt collected and applied in satisfaction of their claim." *Pittsburgh Carbon*, 119 N.Y. at 53.

Indeed, to apply *Wagoner* here would lead to absurd results. *Wagoner* stands for the proposition that claims against third parties involving debtor malfeasance accrue to creditors, not the Trustee. But under § 544, the Trustee is statutorily empowered to bring such claims on

[12] Indeed, if *in pari delicto* was read to bar all actions on behalf of creditors, it would also bar avoidance actions under § 544(b), but courts have uniformly rejected attempts to bar a trustee's avoidance actions under that provision. No logical distinction can be made between §§ 544(a) and 544(b) as to the inapplicability of *in pari delicto*, as they both involve the assertion of state-law claims in connection with the trustee's status as creditor, not debtor.

behalf of a hypothetical judgment creditor, to which *in pari delicto* has no application. Indeed, under *St. Paul*—which preceded *Wagoner*—creditor claims asserting generalized harm are *exclusively* to be asserted by the Trustee. *Wagoner* and *St. Paul* can be harmonized if, as the *St. Paul* court held, the Trustee has the right to vindicate creditors' interests asserting generalized harm under § 544.

C. *In Pari Delicto* Does Not Apply to Actions by the SIPA Trustee as Bailee of the Customer Property Estate

The Moving Defendants contend that the concepts of *in pari delicto* and the *Wagoner* Rule bar the Trustee from bringing his common law claims as bailee. (JPMC Br. 9–11.) However, these concepts have no application to a SIPA trustee acting on behalf of a customer property estate.

The customer property estate comprises property that is not and was never property of the debtor. This is because a broker has a duty to segregate customer funds from the broker's own funds. "It is important to bear in mind that the single and separate fund is not composed of assets of the debtor, but rather, property of the *customers*." *SEC v. Albert & Maguire Sec. Co., Inc.*, 560 F.2d 569, 574 (3d Cir. 1977) (emphasis added); *Picard v. Chais* (*In re Bernard L. Madoff Inv. Sec.*), 445 B.R. 206, 237–38 (Bankr. S.D.N.Y. 2011) ("In a SIPA proceeding, however, property held by a broker-debtor for the account of a customer is not property of the broker-debtor."). Customer property is deemed to be property of the debtor for a single limited purpose—so that a SIPA trustee can prosecute bankruptcy avoidance actions, which must be done on behalf of the debtor. *See* 15 U.S.C.§ 78fff-2(c)(3); *Hill v. Spencer Sav. & Loan Ass'n* (*In re Bevill, Bresler & Schulman, Inc.*), 94 B.R. 817, 825–26 (D.N.J. 1989) (section 78fff–2(c)(3) creates a legal fiction by deeming customer property to be property of the debtor, relieving SIPA trustee from having to prove that the property belonged to the debtor's estate);

Chais, 445 B.R. at 238 (collecting cases). For any other action that a SIPA trustee can bring that fiction does not apply as the Trustee brings that action not on behalf of the debtor, but on behalf of the customer property estate.

As a SIPA trustee is specifically charged with accumulating customer property for the customer property estate, *Wagoner*'s limitation of a *bankruptcy* trustee's authority to actions on behalf of the debtor has no bearing here. *Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085 (2d Cir. 1995), which follows *Wagoner*, is similarly inapposite.

VI. SLUSA DOES NOT BAR THE TRUSTEE'S CLAIMS

The Moving Defendants ask this Court to do something extraordinary—to use the Securities Litigation Uniform Standards Act ("SLUSA") to stop a federal court-appointed liquidation trustee from fulfilling his statutorily-mandated obligations under the Bankruptcy Code and SIPA. SLUSA was designed to prevent the circumvention of federal securities laws by class action plaintiffs bringing state law-based securities claims. It has no application here. SLUSA cannot be used to pre-empt the efforts of a bankruptcy trustee, as those efforts are excluded from SLUSA's reach by an entity exception written into the statute itself. This reflects Congress's concern at the time of its enactment that while claims brought by bankruptcy trustees may benefit more than fifty creditors of a bankrupt entity, they should not be subject to SLUSA pre-emption because they were not the intended target of the statute. Simply put, bankruptcy trustees are not class action plaintiffs. The Moving Defendants ask this Court to ignore the critical distinction between claims *brought* by more than fifty individuals, which are the focus of SLUSA, and claims which merely *benefit* more than fifty individuals, which are protected from pre-emption by the entity exception written within SLUSA.

SLUSA was enacted to prevent the circumvention of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). Specifically, SLUSA pre-empts meritless shareholder "strike suits" alleging violations of state law so as to avoid the stringent pleading requirements imposed by the PSLRA. Its application here is an attempt to fit a square peg in a round hole. The Trustee's action is not a shareholder strike suit nor does it assert causes of action based on state law to avoid the strict pleading requirements of the federal securities laws. To the contrary, the Trustee's action is replete with just the type of detailed allegations of the Moving Defendants' misconduct which would be required by the PSLRA were these securities fraud claims brought by a plaintiff class. Even failing to recognize these critical distinctions, the Trustee's efforts are protected—as are the efforts of all bankruptcy trustees—by the entity exception written into the statute itself. Like a typical bankruptcy trustee, a SIPA trustee and the estates he represents are protected by the entity exception, which counts certain entities as one person for purposes of SLUSA pre-emption. The only distinction between this Trustee and a typical bankruptcy trustee is that, by statute, a SIPA trustee seeks recovery for the benefit of a dual estate that comprises both preferred creditors (*i.e.*, "customers") and general creditors. This distinction has no effect on the application of the entity exception.

Regardless of the number of individuals who will receive distributions from the fund of customer property, SLUSA does not pre-empt the efforts of an entity when, as in the instant case, that entity was not established for the purpose of bringing the challenged litigation. Because neither the Trustee nor the estates he represents were "established for the purpose of litigation," his efforts are not subject to SLUSA pre-emption.

A. The Policies and Objectives Behind SLUSA Are Not Implicated by the Trustee's Litigation Against the Moving Defendants in Bankruptcy Court

SLUSA was enacted to close a loophole in the PSLRA. Thus, "to understand SLUSA, one must first understand the PSLRA." *LaSala v. Bordier et Cie*, 519 F.3d 121, 128 (3d Cir. 2008). The PSLRA was Congress's response to the ways in which the class-action device was "being used to injure 'the entire U.S. economy' . . . [through] nuisance filings, [the] targeting of deep-pocket defendants, vexatious discovery requests, and [the] 'manipulation by class action lawyers of the clients whom they purportedly represent.'" *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006) (internal citations omitted). Among other things, the PSLRA limited attorneys' fees, set forth a more restrictive process for the selection of lead plaintiffs, and heightened the pleading requirements to allege securities fraud, demanding that plaintiffs allege, with specificity, the misleading statements forming the basis of a fraud claim and facts "giving rise to a strong inference" of scienter. *Id*. at 82.

The PSLRA had an "unintended consequence: it prompted at least some members of the plaintiffs' bar to avoid the federal forum altogether. Rather than face the obstacles set in their path by the [PSLRA], plaintiffs and their representatives began bringing class actions under state law, often in state court." *Id.* Congress enacted SLUSA "[t]o stem this 'shif[t] from Federal to state courts' and 'prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA].'" *Id*. (quoting Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353 §§ 2(2), (5), 112 Stat. 3227, 3227 (1998)); *see also Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101, 108 (2d Cir. 2001).

SLUSA preempts: (i) a covered class action; (ii) based on state law; (iii) alleging untrue statements or omissions of material fact; (iv) in connection with the purchase or sale of; (v) a covered security. 15 U.S.C. § 77p(b). In relevant part, a "covered class action" is a lawsuit in which: "(I) damages are sought on behalf of more than 50 persons or prospective class members . . . or . . . (II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated . . . ." 15 U.S.C. § 77p(f)(2)(A)(i). Significantly, SLUSA contains an entity exception which provides that: "a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action." 15 U.S.C. § 77p(f)(2)(C). As Congress explained, SLUSA was drafted to ensure that the efforts of bankruptcy trustees (or those otherwise "duly authorized by law" "to seek damages on behalf of another entity") would not be pre-empted:

> The class action definition has been changed from the original text . . . to ensure that *the legislation does not cover instances in which a person or entity is duly authorized by law*, other than a provision of state or federal law governing class action procedures, *to seek damages on behalf of another person or entity*. Thus, a *trustee in bankruptcy*, a guardian, a receiver, and other persons or entities duly authorized by law (other than by a provision of state or federal law governing class action procedures) to seek damages on behalf of another person or entity *would not be covered by this provision*.

S. Rep. No. 105-182 at 6 (1998) (emphasis added).

Thus, the Trustee's action does not implicate the concerns addressed by SLUSA and, as Congress made explicitly clear, was never meant to fall within the class of cases SLUSA was designed to preempt. This case is not—and does not in any way resemble—the meritless shareholder "strike suits" which prompted the enactment of SLUSA. *See Adelphia Commc'ns. Corp. v. Bank of Am. N.A.* (*In re Adelphia Commc'ns Corp.*), No. 03-04942 (REG), 2007 WL 2403553, at *3 (Bankr. S.D.N.Y. Aug. 17, 2007) (rejecting use of SLUSA to pre-empt litigation because the Court saw "no nexus between this lawsuit and the ills intended to be addressed by SLUSA, and does not believe that the asserted construction of SLUSA furthers the Congressional intent in enacting this legislation."). Similarly, the Trustee does not here seek to avoid the heightened pleading requirements of federal securities laws through an action based in state law. The Trustee is not a "class representative seeking recovery on his own behalf" or for others similarly situated. Rather, the Trustee is pursuing claims authorized by SIPA and the

Bankruptcy Code on behalf of the BLMIS estate, a judgment creditor, and/or the fund of customer property. This case is not subject to SLUSA preemption.

B. The Rules of Statutory Construction Support the Trustee's Position That SLUSA Does Not Bar the Trustee's Claims

The Moving Defendants claim that "SLUSA bars the Trustee's aggregation and assertion in a single action of state law claims belonging to Madoff's customers, *even if the Trustee has standing to assert such claims*." (JPMC Br. 23) (emphasis added.) Were this Court to accept the Moving Defendants' claim, it would be holding that SLUSA impliedly repealed powers granted to the Trustee under SIPA and the Bankruptcy Code. This cannot be correct.

SIPA was enacted in 1970 as an amendment to the Securities Exchange Act of 1934. *See* 15 U.S.C. § 78bbb. The Bankruptcy Code was enacted in 1978. *See Kelly v. Robinson*, 479 U.S. 36, 44 (1986). As described above, multiple provisions in these statutes provide the Trustee with standing to bring his common law claims against the Moving Defendants. SLUSA was enacted in 1998—after both SIPA and the Bankruptcy Code—as an amendment to the Securities Act of 1933 and the 1934 Act. *See Dabit*, 547 U.S. at 82 n.6. To accept the Moving Defendants' argument is to hold that SLUSA impliedly repeals portions of SIPA and the Bankruptcy Code. Neither the express language of SLUSA nor its legislative history suggest Congress intended this result. In the absence of an expressed intent to the contrary, subsequent legislation is not presumed to repeal existing law. *Frost v. Wenie*, 157 U.S. 46, 57–58 (1895). Thus, the Moving Defendants' reading of SLUSA must be rejected.

C. This Case Is Not a Covered Class Action

1. The Trustee and the Estates He Represents Have "Entity Status"

In accord with the statute's purpose, courts have acknowledged that SLUSA was never meant to preclude lawsuits by a bankruptcy trustee or the entities he represents. *See*, *e.g.*, *Lee v.*

Marsh & McLennan Cos., Inc., No. 06 Civ. 6523 (SWK), 2007 WL 704033, at *4 (S.D.N.Y. Mar. 7, 2007) ("[A] typical Chapter 11 trust established to represent a bankrupt estate for all purposes, including the litigation of outstanding causes of action, is entitled to entity treatment."); *Smith v. Arthur Andersen LLP*, 421 F.3d 989, 1007–08 (9th Cir. 2005) (holding that a bankruptcy trustee satisfied the entity exception under SLUSA because trustee had other responsibilities beyond the lawsuit at issue, and where a contrary finding under SLUSA "could potentially deprive many bankruptcy trusts of the ability to pursue state-law securities fraud claims on behalf of an estate").

In this Court's Order withdrawing the reference in the JPMC case, the Court stated that *Smith* is distinguishable because the trustee there stood in the shoes of the debtor. *Picard v. JPMorgan Chase & Co.* (*In re Bernard L. Madoff*), No. 11 Civ. 0913 (LM), 2011 WL 2119720, at *5 (S.D.N.Y. May 23, 2011). But every bankruptcy trustee ultimately seeks recovery for creditors of the debtor no matter what the trustee's basis for standing.

The entity exception codifies Congress's intent to exclude from SLUSA's reach actions in which bankruptcy trustees are seeking recovery on behalf of the estate, even though that recovery may benefit thousands of creditors. Indeed, just as pension plans and shareholder derivative actions are exempt from SLUSA even though they benefit numerous individuals, so, too, is it irrelevant who benefits here. As the Moving Defendants' own authority acknowledges, the fact that numerous people will benefit from the Trustee's claims is not relevant to SLUSA preclusion. *See Bordier*, 519 F.3d at 133–34.

2. Neither the Trustee Nor the Estates He Represents Were Established for the Purpose of Bringing This Litigation

The application of the entity exception here is clear by the single fact that the Trustee was not "established" for the purpose of bringing this litigation. The language of SLUSA is unambiguous: a lawsuit brought by an entity which was "not established for the purpose of participating in the action" is not a "covered class action," and is, correspondingly, not pre-empted by SLUSA. 15 U.S.C. § 77p(f)(2)(C).

This threshold inquiry is dispositive of the Moving Defendants' argument: because neither the Trustee nor the estates he represents were established for the purpose of bringing this litigation, the Trustee's efforts are protected by the entity exception, and no further analysis is required. *See Marsh & McLennan*, 2007 WL 704033, at *4.

As explained by Judge Haight in *LaSala v. Bank of Cyprus Public Company Ltd.*:

> Thus, if damages are sought on behalf of an entity (perhaps in addition to other persons), and the entity itself benefits multiple persons, that entity will nonetheless be treated as one person if it was not established for the purpose of participating in the action. *In other words, the beneficiaries of damages that would accrue to an entity will only be counted towards the 50-person limit under circumstances where the entity was established to participate in the action.*

510 F. Supp. 2d 246, 268 (S.D.N.Y. 2007) (emphasis added); *see also LaSala v. UBS, AG*, 510 F. Supp. 2d 213, 234 (S.D.N.Y. 2007). Neither the Trustee nor the estates he represents were established for the primary purpose of bringing this litigation.

The Trustee was appointed on December 15, 2008 by Judge Stanton. As required by SIPA, Judge Stanton's order appointed the Trustee for the purpose of liquidating the estate of BLMIS, and then removed that liquidation proceeding to the Bankruptcy Court. *See* Order, *SEC v. Bernard L. Madoff*, No. 08-10791 (LLS) (Dec. 15, 2008), Dkt. No. 4. Judge Stanton did not appoint the Trustee in order to bring this action. At the time he was appointed, the Trustee was a stranger to the facts, circumstances, and evidence connected to the Ponzi scheme. He was not yet aware of the Moving Defendants' connection to Madoff or of the Moving Defendants' substantial assistance to Madoff thus furthering the Ponzi scheme, as alleged in the Amended Complaint. Thus, the Trustee was not—and could not—have been established for the primary purpose of bringing this litigation (or, indeed, any other adversarial proceeding brought to recover funds for BLMIS).

The Trustee's responsibilities are far broader. He was appointed to oversee all aspects of the consolidated liquidation of BLMIS, which include, among other things, marshaling and selling certain assets of BLMIS, determining over 16,000 customer claims, creating processes and procedures for the orderly administration of the estates, allocating customer property among the customers of BLMIS, and bringing litigation where necessary to recover monies to be equitably distributed, *pro rata*, through the fund of customer property to customers with allowed claims. *See* Order on Application for an Entry of an Order Approving Form and Manner of Publication and Mailing of Notices, Specifying Procedures for Filing, Determination, and Adjudication of Claims; and Providing Other Relief, *SIPC v. Bernard L. Madoff Inv. Sec. LLC*, No. 08-01789-BRL (Dec. 23, 2008), Dkt. No. 12 ("Trustee Procedures Order"). That neither the Trustee nor the estates he represents were established for the primary purpose of suing the Moving Defendants should end the inquiry into SLUSA pre-emption. *UBS,* 510 F. Supp. 2d at 234.

This action is distinct from the case cited by the Moving Defendants, *Cape Ann Investors LLC v. Lepone*, 296 F. Supp. 2d 4, 10 (D. Mass. 2003). (JPMC Br. 28–29.) In *Cape Ann*, the prosecuting trust was not protected by the entity exception because it was specifically created for the primary purpose of bringing the challenged litigation. *Cape Ann*, 296 F. Supp. 2d at 9–12. Further, the trustee in that case brought state-law based fraud claims to circumvent federal securities law; this is the precise conduct against which SLUSA was directed. *Id.* at 10–12; *see also RGH*, 71 A.D.3d at 205.

D. The Common Law Claims Are Not Brought "On Behalf of" Individual Customers

SLUSA also does not apply because the common law claims are brought by the Trustee under theories of standing that do not implicate SLUSA. For his contribution claim, the Trustee stands in the shoes of BLMIS, just like the bankruptcy trustee in *Smith*. With regard to the remaining common law claims, the Trustee acts as a hypothetical judgment creditor, a bailee of customer property, and enforcer of SIPC's subrogation rights. While the Trustee has alleged that he could have standing pursuant to assignments from customers, he has no such assignments to date. If he did, on the Moving Defendants' theory he could easily assert 50 or fewer assignments if SLUSA were deemed to be at all relevant. But limiting his ability to achieve his statutory obligations in this manner points to the absurdity of applying SLUSA in this context at all.

Significantly, the two main cases discussed by the Moving Defendants are not bankruptcy trustee cases at all, but cases dealing with assignments made to trusts. And, even in those cases, SLUSA was not held to preclude claims in those suits. In *RGH Liquidating Trust v. Deloitte & Touche LLP*, No. 0000961/2007, 2011 WL 2471542 (N.Y. June 23, 2011), the New York Court of Appeals addressed an action brought by a trust. Groups of unsecured general creditors had assigned claims to the trust, which included claims against the debtor's accountant and actuary. The defendants argued that the trust's claims were preempted by SLUSA because they were being brought on behalf of more than 50 unsecured creditors. Importantly, the New York Court of Appeals held that the entity exception applied to the trustee's claims and protected the action from SLUSA preemption. The court explained that "[b]y adding a single-entity exemption in the final bill to cover legal entities that may act on behalf of numerous beneficiaries, Congress made sure that, in bringing suits in their own names, these entities would be counted as one person." The Moving Defendants' only rebuttal to this case is that the majority made the wrong decision.

In *Bordier*, the Third Circuit held that SLUSA would not preclude the prosecution of state law aiding and abetting breach of fiduciary duty claims which had passed from a corporation to a bankruptcy estate to a trust. 519 F.3d at 137. The trust at issue was a hybrid between a litigation trust and a liquidating trust, and its purpose was not only to litigate, but to distribute assets. *Id*. at 127 n.1. The district court had ruled that the single entity exception under § 78bb(f)(5)(D) would not apply because the trust was established for the primary purpose of litigation. *Id*. at 133. Accordingly, for this reason, the Third Circuit "looked through" the trust to determine its constituents, acknowledging that unless an entity were "established for the purpose of bringing the action, *i.e.*, to circumvent SLUSA," "the court is to follow the usual rule of not looking through an entity to its constituents." *Id*. at 133–34. Looking through the entity, the *Bordier* court decided to look at the original owners of the claims at issue precisely because the case involved assignments to a trust and the lower court had found that the trust was established primarily to pursue ligation. Unlike this case, *Bordier* did not involve claims by a bankruptcy estate trustee acting in his fiduciary capacity and who clearly was not "established" for the primary purpose of litigation. Not only does *Bordier* not stand for the proposition that looking through an entity is appropriate under the circumstances here, it also does not stand for the proposition that when "looking through" a *bankruptcy estate*, one should count the creditors whose claims are being asserted by the only party with standing to assert those claims—the trustee.

E. The Trustee Has Not Alleged That the Moving Defendants Committed Securities Fraud

Because the claims against the Moving Defendants are not based on untrue statements or omissions in connection with the purchase or sale of covered securities, there is no SLUSA pre-emption. And the Moving Defendants' tortious conduct, as described in the Amended Complaint, is not "in connection with" securities fraud, but is related to their total disregard of their responsibilities to monitor, manage and/or safeguard investments. For this reason as well, the Trustee's common law claims do not fall within the range of actions preempted by SLUSA.

1. No Securities Were Purchased or Sold

Since the securities did not exist, SLUSA does not apply. In *In re J.P. Jeanneret Associates, Inc.*, this Court stated that for purposes of Rule 10(b), "[t]he Court has not found any Supreme Court or Second Circuit jurisprudence that directly addresses whether phony purchases or sales of securities can be relied on to satisfy the 'in connection with' requirement." 69 F. Supp. 2d 340, 363 (S.D.N.Y. 2011) (McMahon, J.). Lacking such guidance from a higher court, this Court held in that case that "it seems likely that the requirement can be satisfied in circumstances like those at bar—where the plaintiffs part with money intending that it be invested in securities, only to have the person to whom that money is entrusted steal it." *Id.*

Here, however, the Second Circuit has ruled that Madoff's purported trades can have *no legal effect*. In *In re BLMIS*, the Second Circuit, in a decision written by Chief Judge Jacobs, ruled:

> The statutory definition of "net equity" does not require the Trustee to aggravate the injuries caused by Madoff's fraud. Use of the Last Statement Method in this case would have the absurd effect of treating fictitious and arbitrarily assigned paper profits as real and would give legal effect to Madoff's machinations.

2011 WL 3568936, at *5; *see also id.* at *11 ("assessing 'net equity' based on . . . customer statements would require the Trustee to establish each claimant's 'net equity' based on a fiction created by the perpetrator of the fraud"). The Second Circuit's decision indicates that the fiction maintained by a fraudster, or an investor's expectations based on that fiction, should not be determinative of legal rights. Nor should this Court allow a fiction to determine legal rights. There were no securities sold or purchased here, and therefore this case falls outside of SLUSA.

2. Even If There Had Been Securities, Madoff's Fraud Is Too Remote for SLUSA to Apply

Even if the securities had been real, the securities fraud committed by Madoff does not mandate the application of SLUSA in any event. Courts of this Circuit have previously addressed this very issue. In *Anwar v. Fairfield Greenwich Ltd.*, 728 F. Supp. 2d. 372 (S.D.N.Y. 2010) (Marrero, J.), a group of investors in various BLMIS feeder funds brought securities fraud claims, including claims for breaches of fiduciary duties, against those funds and certain service providers. *Id.* at 404–21, 423–42. The court held that because the relevant securities fraud was committed by Madoff, not by the feeder funds, the complaint did not allege tortious conduct "in connection with" securities fraud, so as to be pre-empted by SLUSA. *Id.* at 398.

Similarly, in this case, the Trustee has alleged that the Moving Defendants' conduct aided and abetted Madoff's fraud, breach of fiduciary duty and conversion, that the Moving Defendants knowingly participated in that fraud, that the Moving Defendants converted customer property, that the Moving Defendants were unjustly enriched, and that they must contribute as joint tortfeasors. As the district court explained in *Anwar*, these types of claims cannot be pre-empted by SLUSA because the Moving Defendants' participation in the fraud was only tangentially related to securities, if they existed at all:

> Though the Court must broadly construe SLUSA's "in connection with" phrasing, stretching SLUSA to cover this chain of investment—from Plaintiffs' initial investment in the Funds, the Funds' reinvestment with Madoff, Madoff's supposed purchases of covered securities, to Madoff's sale of those securities and purchases of Treasury bills—snaps even the most flexible rubber band.

Id. at 399; *see also Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 750 F. Supp. 2d 450, 453–56 (S.D.N.Y. 2010) (investment in hedge funds, even when those funds indisputably invest in covered securities, did not implicate SLUSA); *UBS*, 510 F. Supp. 2d at 240 ("If merely making allegations of fraud somewhere in the complaint were sufficient to bring the case within the reach of SLUSA, a class action complaint for commission of an environmental tort, that also alleged that the company fraudulently altered its books and thereby deceived shareholders, would be preempted, even if the claim against the defendant had nothing to do with securities fraud.").[13]

[13] Nor is the Second Circuit's decision in *MLSMK Investment Co. v. JPMorgan Chase & Co.*, No. 10-3040-CV, 2011 WL 2640579 (2d Cir. July 7, 2011), apposite. In *MLSMK*, the Second Circuit held only that allegations of predicate acts of securities fraud are sufficient to bar a RICO action under the PSLRA. When the plaintiff then tried to run from his own allegations by contending that the defendant itself did not engage in securities fraud, the Second Circuit stated, *in dicta*, that allegations amounting to aiding and abetting securities fraud are sufficient to fall under Rule 10(b) and preclude a RICO claim.

CONCLUSION

For the foregoing reasons, the Moving Defendants' motion should be denied.

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Respectfully submitted,

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