

# 13-1785-bk

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IN THE  
**United States Court of Appeals**  
FOR THE SECOND CIRCUIT

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IRVING H. PICARD, TRUSTEE FOR THE SUBSTANTIVELY CONSOLIDATED  
SIPA LIQUIDATION OF BERNARD L. MADOFF INVESTMENT SECURITIES LLC  
AND THE ESTATE OF BERNARD L. MADOFF,

—against— *Plaintiff-Appellant,*

ERIC T. SCHNEIDERMAN, BART M. SCHWARTZ, RALPH C. DAWSON,  
J. EZRA MERKIN, GABRIEL CAPITAL CORPORATION,

*Defendants-Appellees,*

SECURITIES INVESTOR PROTECTION CORPORATION,  
STATUTORY INTERVENOR PURSUANT TO SECURITIES INVESTOR  
PROTECTION ACT, 15 U.S.C. § 78eee(d),

*Intervenor.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK

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(Pages A-601 to A-900)**

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EXHIBIT B

**Bernard L. Madoff Investment Securities, LLC**  
**Summary of Cash Transfers to Defendants**

For the Period from 12/1/95 - 12/11/08				
A/C#	Account Name	Date	Transfer	Amount
1FR070	ARIEL FUND LTD	Aug-02	MONTHLY WITH AMT	14,055
1FR070	ARIEL FUND LTD	Sep-02	MONTHLY WITH AMT	43,484
1FR070	ARIEL FUND LTD	Oct-02	MONTHLY WITH AMT	25
1FR070	ARIEL FUND LTD	Nov-02	MONTHLY WITH AMT	9,049
1FR070	ARIEL FUND LTD	Dec-02	MONTHLY WITH AMT	22,600
1FR070	ARIEL FUND LTD	Jan-03	MONTHLY WITH AMT	1,187
1FR070	ARIEL FUND LTD	Feb-03	MONTHLY WITH AMT	34,797
1FR070	ARIEL FUND LTD	Mar-03	MONTHLY WITH AMT	41,371
1FR070	ARIEL FUND LTD	Apr-03	MONTHLY WITH AMT	6,221
1FR070	ARIEL FUND LTD	May-03	MONTHLY WITH AMT	922
1FR070	ARIEL FUND LTD	Jun-03	MONTHLY WITH AMT	45,523
1FR070	ARIEL FUND LTD	Jul-03	MONTHLY WITH AMT	29,798
1FR070	ARIEL FUND LTD	Aug-03	MONTHLY WITH AMT	36,358
1FR070	ARIEL FUND LTD	Sep-03	MONTHLY WITH AMT	32,370
1FR070	ARIEL FUND LTD	Oct-03	MONTHLY WITH AMT	17,344
1FR070	ARIEL FUND LTD	Nov-03	MONTHLY WITH AMT	39,773
1FR070	ARIEL FUND LTD	Dec-03	MONTHLY WITH AMT	39,768
1FR070	ARIEL FUND LTD	Jan-04	MONTHLY WITH AMT	4,785
1FR070	ARIEL FUND LTD	Feb-04	MONTHLY WITH AMT	20,309
1FR070	ARIEL FUND LTD	Mar-04	MONTHLY WITH AMT	31,787
1FR070	ARIEL FUND LTD	Apr-04	MONTHLY WITH AMT	2,053
1FR070	ARIEL FUND LTD	May-04	MONTHLY WITH AMT	24,412
1FR070	ARIEL FUND LTD	Jun-04	MONTHLY WITH AMT	38,590
1FR070	ARIEL FUND LTD	Jul-04	MONTHLY WITH AMT	13,383
1FR070	ARIEL FUND LTD	Aug-04	MONTHLY WITH AMT	61
1FR070	ARIEL FUND LTD	Sep-04	MONTHLY WITH AMT	28,367
1FR070	ARIEL FUND LTD	Oct-04	MONTHLY WITH AMT	22,115
1FR070	ARIEL FUND LTD	Nov-04	MONTHLY WITH AMT	570
1FR070	ARIEL FUND LTD	Dec-04	MONTHLY WITH AMT	25,717
1FR070	ARIEL FUND LTD	Jan-05	MONTHLY WITH AMT	915
1FR070	ARIEL FUND LTD	Feb-05	MONTHLY WITH AMT	16,042
1FR070	ARIEL FUND LTD	Mar-05	MONTHLY WITH AMT	69,667
1FR070	ARIEL FUND LTD	Apr-05	MONTHLY WITH AMT	33,109
1FR070	ARIEL FUND LTD	May-05	MONTHLY WITH AMT	43
1FR070	ARIEL FUND LTD	Jun-05	MONTHLY WITH AMT	16,017
1FR070	ARIEL FUND LTD	Jul-05	MONTHLY WITH AMT	29,623
1FR070	ARIEL FUND LTD	Sep-05	MONTHLY WITH AMT	1,753
1FR070	ARIEL FUND LTD	Oct-05	MONTHLY WITH AMT	27,842
1FR070	ARIEL FUND LTD	Nov-05	MONTHLY WITH AMT	25,532
1FR070	ARIEL FUND LTD	Dec-05	MONTHLY WITH AMT	78,651
1FR070	ARIEL FUND LTD	Jan-06	MONTHLY WITH AMT	18,505
1FR070	ARIEL FUND LTD	Feb-06	MONTHLY WITH AMT	39,535
1FR070	ARIEL FUND LTD	Mar-06	MONTHLY WITH AMT	113,685
1FR070	ARIEL FUND LTD	Apr-06	MONTHLY WITH AMT	58,681
1FR070	ARIEL FUND LTD	May-06	MONTHLY WITH AMT	73,171

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**EXHIBIT B**

**Bernard L. Madoff Investment Securities, LLC  
 Summary of Cash Transfers to Defendants**

For the Period from 12/1/95 - 12/11/08				
A/C#	Account Name	Date	Transfer	Amount
1FR070	ARIEL FUND LTD	Jun-06	MONTHLY WITH AMT	111,315
1FR070	ARIEL FUND LTD	Jul-06	MONTHLY WITH AMT	39,474
1FR070	ARIEL FUND LTD	Aug-06	MONTHLY WITH AMT	34,144
1FR070	ARIEL FUND LTD	Sep-06	MONTHLY WITH AMT	121,270
1FR070	ARIEL FUND LTD	Oct-06	MONTHLY WITH AMT	50,855
1FR070	ARIEL FUND LTD	Nov-06	MONTHLY WITH AMT	28,977
1FR070	ARIEL FUND LTD	Dec-06	MONTHLY WITH AMT	179,390
1FR070	ARIEL FUND LTD	Jan-07	MONTHLY WITH AMT	56,400
1FR070	ARIEL FUND LTD	Feb-07	MONTHLY WITH AMT	21
1FR070	ARIEL FUND LTD	Mar-07	MONTHLY WITH AMT	78,287
1FR070	ARIEL FUND LTD	Apr-07	MONTHLY WITH AMT	74,535
1FR070	ARIEL FUND LTD	May-07	MONTHLY WITH AMT	48,815
1FR070	ARIEL FUND LTD	Jun-07	MONTHLY WITH AMT	205,980
1FR070	ARIEL FUND LTD	Jul-07	MONTHLY WITH AMT	34,487
1FR070	ARIEL FUND LTD	Aug-07	MONTHLY WITH AMT	12,683
1FR070	ARIEL FUND LTD	Sep-07	MONTHLY WITH AMT	45,275
1FR070	ARIEL FUND LTD	Oct-07	MONTHLY WITH AMT	28,361
1FR070	ARIEL FUND LTD	Nov-07	MONTHLY WITH AMT	9,370
1FR070	ARIEL FUND LTD	Dec-07	MONTHLY WITH AMT	36,240
1FR070	ARIEL FUND LTD	Jan-08	MONTHLY WITH AMT	4,119
1FR070	ARIEL FUND LTD	Feb-08	MONTHLY WITH AMT	11,381
1FR070	ARIEL FUND LTD	Mar-08	MONTHLY WITH AMT	123,989
1FR070	ARIEL FUND LTD	Apr-08	MONTHLY WITH AMT	48,738
1FR070	ARIEL FUND LTD	May-08	MONTHLY WITH AMT	46,423
1FR070	ARIEL FUND LTD	Jun-08	MONTHLY WITH AMT	126,053
1FR070	ARIEL FUND LTD	7/7/2008	WIRE	16,200,000
1FR070	ARIEL FUND LTD	Jul-08	MONTHLY WITH AMT	42
1FR070	ARIEL FUND LTD	Aug-08	MONTHLY WITH AMT	15,648
1FR070	ARIEL FUND LTD	Sep-08	MONTHLY WITH AMT	170,850
1FR070	ARIEL FUND LTD	Oct-08	MONTHLY WITH AMT	19,413
1FR070	ARIEL FUND LTD	Nov-08	MONTHLY WITH AMT	3
<b>SUBTOTAL</b>				<u>□ 19,518,697</u>
1G0321	GABRIEL CAPITAL LP	7/7/2008	WIRE	□ 17,400,000
<b>SUBTOTAL</b>				<u>□ 17,400,000</u>
<b>GRAND TOTAL</b>				<u>□ 564,652,194</u>

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# **EXHIBIT F**

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**UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**

SECURITIES INVESTOR PROTECTIONS  
CORPORATION,

Plaintiff-Applicant.

- against -

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

In re:

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Debtor.

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

Plaintiff,

- against -

J. EZRA MERKIN, GABRIEL CAPITAL, L.P.,  
ARIEL FUND LTD., ASCOT PARTNERS, L.P.,  
and GABRIEL CAPITAL CORP.,

Defendants.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantially Consolidated)

Adv. Pro. No. 09-1182 (BRL)

**MEMORANDUM OF LAW IN SUPPORT OF MOTION OF BART M. SCHWARTZ,  
AS RECEIVER OF DEFENDANTS ARIEL FUND LIMITED  
AND GABRIEL CAPITAL, L.P., TO WITHDRAW THE REFERENCE**

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Bart M. Schwartz, as Receiver (“Receiver”) of defendants Ariel Fund Limited (“Ariel”) and Gabriel Capital, L.P. (“Gabriel” and together with Ariel, the “Funds”) respectfully submits this memorandum of law in support of his motion, pursuant to 28 U.S.C. § 157(d), Rule 5011 of the Federal Rules of Bankruptcy Procedure, and Rule 5011-1 of the Local Rules of the Southern District of New York, to withdraw from the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”) the reference of this adversary proceeding (the “Adversary Proceeding”) brought against the Funds by Irving H. Picard, the trustee (the “Trustee”) for the liquidation of Bernard L. Madoff Investment Securities LLC (“BLMIS”).<sup>1</sup> In support of his motion, the Receiver respectfully states as follows:

#### **PRELIMINARY STATEMENT**

Through the Adversary Proceeding, the Trustee seeks to avoid, as fraudulent transfers, withdrawals made by the Funds of their principal investment from their brokerage accounts with BLMIS. The Trustee seeks to recover an aggregate of \$33 million that the Funds received from BLMIS, which represents less than 5% of the over \$300 million they invested with BLMIS and less than 10% of the amount reflected on the account statements they received in the months preceding BLMIS’ bankruptcy filing. By this motion, the Receiver requests that the District Court withdraw the reference of the Adversary Proceeding to resolve the same issues the District Court already has found on numerous prior occasions warrant withdrawing the reference in other BLMIS-related proceedings which have been brought by the Trustee.

Specifically, the Receiver submits that withdrawal of the reference with respect to the entirety of the Adversary Proceeding is warranted for two reasons. First, the fraudulent transfer

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<sup>1</sup> In addition to the claims against the Funds, the Trustee also has asserted claims in the Adversary Proceeding against Ascot Partners, L.P., J. Ezra Merkin and Gabriel Capital Corp.

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claims asserted in the Trustee's complaint raise significant questions regarding the interpretation of the Securities Investor Protection Act ("SIPA") and other federal and state securities laws, including whether SIPA and applicable securities laws authorize the avoidance of redemption payments made to an investor of less than the amounts the investor deposited with BLMIS. The Adversary Proceeding also requires the District Court to determine whether SIPA can be interpreted to authorize a result that is inconsistent with a clearly applicable defense under Section 546(e) of the Bankruptcy Code.

In addition, given the United States Supreme Court's recent decision in *Stern v. Marshall*, the immediate withdrawal of this entire adversary proceeding for all purposes will avoid any Constitutional issues relative to the power of the Bankruptcy Court to enter final judgment in this matter. All of these issues must be resolved by the District Court. Indeed, the District Court has withdrawn the reference on identical grounds in at least four other BLMIS-related suits. The same result is warranted here.

## **BACKGROUND**

### **A. THE MADOFF PONZI SCHEME AND THE FUNDS**

#### **1. Madoff and BLMIS**

Bernard L. Madoff Investment Securities was a New York limited liability company registered with the SEC as a broker-dealer and, as of 2005, also as an investment adviser. *See* Memorandum Decision and Order Granting in Part and Denying In Part Defendants' Motions to Dismiss Trustee's Complaint, No. 09-1182, (Bankr. S.D.N.Y. November 17, 2011) (Hon. Burton R. Lifland) (the "Order") at 5 (a copy of which is attached as Exhibit A to the Declaration of John L. Scott in Support of Motion of Bart M. Schwartz, as Receiver of defendants Ariel Fund Limited and Gabriel Capital, L.P. to Withdraw the Reference, the "Scott Decl."). By virtue of its

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registration as broker-dealer, BLMIS was a member of the Securities Investor Protection Corporation (“SIPC”), and it was run by its founder, Bernard L. Madoff (“Madoff”), along with several family members and other employees. *Id.* BLMIS was organized into three business units: the market making unit, the proprietary trading unit, and the investment advisory business. *Id.*

On December 11, 2008, Madoff was arrested by federal agents and charged with securities fraud. *Id.* at 4. Madoff pled guilty to all charges and is currently serving a 150 year prison sentence. Madoff’s fraudulent activity was perpetrated through BLMIS’ investment advisory unit. *Id.* at 5. To facilitate his fraud, Madoff generated customer account statements purportedly showing securities that either were held or had been traded, as well as the gains and losses in those accounts. However, as Madoff admitted in his plea hearing, the purported trades reflected in customers’ account statements never took place; rather, Madoff, along with some of his co-conspirators, fabricated the fake account statements and disseminated them to BLMIS’ numerous customers. *Id.* at 6.

On December 15, 2008, SIPC filed an application seeking a decree that the customers of BLMIS are in need of the protections afforded under the Securities Investor Protection Act of 1970 (“SIPA”) (15 U.S.C. §§ 78aaa et seq.). The District Court (Stanton, J.) granted SIPC’s application and entered an order on December 15, 2008, placing BLMIS’ customers under the protection of SIPA. That order appointed the Trustee as trustee for the liquidation of BLMIS’ business. *Id.* at 5. Judge Stanton’s order also provided, *inter alia*, for the transfer of the SIPA liquidation proceeding to the United States Bankruptcy Court for this District pursuant to 15 U.S.C. § 78eee(b)(4).

2. The Funds

The Funds are investment vehicles that pooled together investors' monies and made investments on their behalf. Ariel was incorporated in the Cayman Islands and was suitable for non-U.S. and U.S. tax-exempt investors. Gabriel was a Delaware partnership suitable for U.S. taxable investors. Other than that difference, the Funds followed substantially the same investment strategy and, for the most part, their investments were made *pari passu*. The Funds were managed by J. Ezra Merkin ("Merkin") and his investment advisory firm, Gabriel Capital Corporation ("GCC"). *See* Order at 6-7.

The Funds opened accounts with BLMIS at least as early as August 2000 and, in doing so, had executed a Customer Agreement, an Option Agreement, and a Trading Authorization Limited to Purchases and Sales of Securities and Options (collectively, the "Account Agreements") that enabled BLMIS to effectuate trades on their behalf. *Id.* at 7. Throughout the years of maintaining their BLMIS accounts, the Funds transmitted more than \$150 million each (for an aggregate of more than \$300 million) to be traded in accordance with their Account Agreements. *See* Declaration of Lance Gotthoffer in Support of Motion by Defendants Ariel Fund Limited and Gabriel Capital L.P. to Dismiss the Second Amended Complaint (of which Exhibits A-I and L-V are not included, a copy of which is attached as Exhibit B to the Scott Decl.). At the time of BLMIS' collapse, the Funds' account statements reflected a balance of approximately \$308 million each. *Id.*, Exhibit J–K. Throughout the years of maintaining their accounts, each of Ariel and Gabriel only submitted one withdrawal request. That occurred in June of 2008 (*i.e.*, 6 months before the fraud was revealed) – in the amount of \$16.2 million for Ariel and \$17.4

million for Gabriel – and represented only a small fraction of the Funds’ investment with BLMIS.<sup>2</sup>

**B. THE INSTANT ADVERSARY PROCEEDING**

In April 2009, the Trustee brought the Adversary Proceeding against the Funds. Thereafter, the Trustee’s complaint was amended to seek recovery of the two transfers made by BLMIS to the Funds (the “Transfers”) as actual and constructive fraudulent conveyances pursuant to the Bankruptcy Code and New York Debtor Creditor Law (“NYDCL”) (the “Complaint”, a copy of which is attached as Exhibit C to the Scott Decl.). In addition, the Trustee sought an accounting and immediate turnover of the Transfers, pursuant to Section 542 of the Bankruptcy Code, and to disallow the Funds’ customer claims in BLMIS’ SIPA liquidation proceeding.

In January 2010, the Funds moved to dismiss the Trustee’s claims. One of the primary arguments articulated by the Funds in support of dismissal was that the Trustee may not avoid the Transfers as constructive fraudulent conveyances under Section 548(A)(1)(B) because the Transfers were made by a stockbroker (BLMIS) to a financial institution (the Funds’ bank account at JP Morgan Chase) pursuant to the Funds’ securities contracts with BLMIS (*i.e.* the Account Agreements). As such, the Transfers fall within the “safe harbor” of Section 546(e) of the Bankruptcy Code which “precludes avoidance of transfers made in connection with a securities contract.” *See* Corrected Memorandum of Law in Support of Motion by Defendants Ariel Fund Limited and Gabriel Capital L.P. to Dismiss the Second Amended Complaint, dated January 25, 2010, at p. 27 (a copy of which is attached as Exhibit D to the Scott Decl.). The Funds

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<sup>2</sup> The Funds pointed the Trustee to documents in his possession which showed these redemptions were made to meet redemption requests from investors in the Funds. The Trustee never disputed this fact, but nevertheless continues to prosecute the Adversary Proceeding.

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also argued that the Transfers were made in good faith for “value” and on account of an antecedent debt since the Funds held tort claim to recover 100% of the amount of their principal investment based on BMLIS’s fraud, and therefore they cannot even be recovered as actual fraudulent conveyances under Section 548(a)(1)(A) of the Bankruptcy Code – otherwise the sole exception to the safe harbor of Section 546(e). *Id.* at pp. 12-13; *see also id.* at pp. 29-30.

On November 17, 2010, Judge Lifland issued an order finding that the Trustee had not adequately stated a claim for the immediate turnover of funds and accounting under section 542 of the Bankruptcy Code. The Bankruptcy Court found that the Trustee’s other claims were adequately alleged and allowed them to proceed. Notably for purposes of this motion, the Bankruptcy Court considered and rejected the Funds’ Section 546(e) defense as “at best premature,” but noted that application of Section 546(e) to the Transfers would be “contrary to the purpose of the safe harbor provision and incompatible with SIPA.” *See* Order at pp. 31, 33.

On August 31, 2011, Judge Wood of the United States District Court for the Southern District of New York (the “District Court”) denied the Receiver’s motion for leave to appeal the Bankruptcy Court’s decision, finding that the Receiver had not established a substantial ground for disputing the correctness of the standards applied by the Bankruptcy Court. *See* Order, Case No. 11-00012 (S.D.N.Y. August 31, 2011) (Hon. Kimba M. Wood), pp. 10, 15, 18, 23, 25 (a copy of which is attached as Exhibit E to the Scott Decl.). The parties in the Adversary Proceeding currently are engaged in fact discovery, but depositions have not yet been scheduled.

**C. THE BANKRUPTCY COURT’S ORDER ESTABLISHING  
A DEADLINE FOR WITHDRAWING THE REFERENCE**

On March 5, 2012, the Bankruptcy Court entered an administrative order establishing April 2, 2012 as the deadline for filing a motion to withdraw the reference on the basis of issues arising in any adversary proceeding which has been commenced by the Trustee. Administrative

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Order Establishing Deadline For Filing Motions to Withdraw the Reference, dated March 5, 2012 (“Administrative Order”) (a copy of which is attached as Exhibit F to the Scott Decl.). Judge Lifland noted in the Administrative Order that motions to withdraw the reference have already been filed in over 400 such proceedings.

### ARGUMENT

The fraudulent transfer claims asserted in the Adversary Proceeding warrant withdrawal of the reference by the District Court. Indeed, withdrawal of the reference is mandatory under 28 U.S.C. § 157(d) because the resolution of the claims in the Complaint require the consideration of fundamental issues regarding the interpretation of SIPA, other federal securities laws, and their interaction with the Bankruptcy Code. Resolution of these issues will directly affect the resolution of this case and likely will affect all of the cases brought by the Trustee against BLMIS customers. Accordingly, for the reasons set forth below, the Receiver respectfully requests that the District Court withdraw the reference of the Adversary Proceeding.

#### I. WITHDRAWAL OF THE REFERENCE IS MANDATORY

Section 157(d) of Title 28 of the United States Code provides:

The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that *resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.*

28 U.S.C. § 157(d) (emphasis added).

Pursuant to 28 U.S.C. § 157(d), the District Court may *sua sponte* withdraw the reference for “a wide variety of reasons.” *Picard v. HSBC Bank PLC*, 450 B.R. 406, 409 (S.D.N.Y. 2011). The nature of the questions raised by the Trustee in the Adversary Proceeding, and their application to the BLMIS case generally, constitute such a reason. *See, e.g., In re Chateaugay*

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*Corp.*, 86 B.R. 33, 36-39 (S.D.N.Y. 1987) (finding mandatory and permissive withdrawal of core bankruptcy claims appropriate because claims involved significant issues of first impression of bankruptcy and ERISA law that could impact many present and future retirees and their employers). In addition, “a litigant can mandate withdrawal of the bankruptcy reference where the movant shows that, absent the withdrawal, the bankruptcy judge would be obliged ‘to engage in significant interpretation, as opposed to simple application, of federal laws apart from the bankruptcy statute.’” *HSBC*, 450 B.R. at 409 (citing *City of New York v. Exxon Corp.*, 932 F.2d 1020, 1026 (2d Cir. 1991)); see also *Picard v. JP Morgan Chase & Co.*, 454 B.R. 307, 312 (S.D.N.Y. 2011) (same); *Enron Power Mktg., Inc. v. Cal. Power Exch. Corp. (In re Enron Corp.)*, No. 04 Civ. 8177, 2004 WL 2711101, at \*2 (S.D.N.Y. Nov. 23, 2004) (holding that the reference of any proceeding that involves “substantial and material consideration” of non-bankruptcy federal law must also be withdrawn) (quoting *Shugrue v. Air Line Pilots Ass’n Int’l (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 995 (2d Cir. 1990)).

Thus, where significant interpretation of the securities laws has been required, withdrawal has been found to be mandatory. See, e.g., *Bear, Stearns Sec. Corp. v. Gredd*, No. 01 CIV 4379, 2001 WL 840187, at \*4 (S.D.N.Y. July 25, 2001) (withdrawal mandatory where SEC rule potentially precluded application of the Bankruptcy Code avoidance provisions because debtor would not have an interest in the subject property); *In re Cablevision S.A.*, 315 B.R. 818, 821 (S.D.N.Y. 2004) (withdrawal mandatory where the interplay between the federal securities laws and the ancillary proceeding section of the Bankruptcy Code was required); *In re Enron Corp.*, 388 B.R. 131, 140 (S.D.N.Y. 2008) (withdrawal mandatory where trustee’s theory of secondary liability under Section 550(a)(1) of the Bankruptcy Code, if it were reached, involved substantial and material consideration of the Securities Act). Mandatory withdrawal also is

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required where there appears to be a conflict between the Bankruptcy Code and other federal laws. *See HSBC*, 460 B.R. at 412 (deeming a conflict between SIPA and bankruptcy law as “something that itself warrants withdrawal of the bankruptcy reference”); *see also In re Cablevision*, 315 B.R. at 821 (“The very existence of a dispute as to whether the rights of [investors] under the [Trust Indenture Act] and Williams Act supersede Section 304 [of the Bankruptcy Code] or whether the Bankruptcy Code overrides the TIA, regardless of the ultimate resolution of such dispute, mandates withdrawal.”); *Gredd*, 2001 WL 840187, at \*2-4 (withdrawing reference where federal securities laws “arguably conflict[ed]” with the Bankruptcy Code).

As set forth below, the resolution of the Adversary Proceeding requires the interpretation of significant issues regarding the scope of the Trustee’s authority under SIPA and its effect on other federal laws, including the Bankruptcy Code. As such, withdrawal of the reference is mandated and appropriate. Indeed, because SIPA is codified under Title 15 as a securities law, a “substantial issue under SIPA is therefore, almost by definition, an issue ‘the resolution of [which] requires consideration of both title 11 and other laws of the United States.’” *HSBC*, 450 B.R. at 410 (quoting 28 U.S.C. § 157(d)). As the District Court instructed in another BLMIS-related proceeding:

[A]n issue that requires significant interpretation of SIPA undoubtedly requires consideration of laws other than Title 11. Regardless of a bankruptcy court’s familiarity with a statute outside of Title 11, the requirements for mandatory withdrawal are satisfied if the proceeding requires consideration of a law outside of Title 11.

*JP Morgan Chase*, 454 B.R. at 316.

The Trustee contends in the Adversary Proceeding that SIPA must be interpreted to expand the avoidance powers of the Trustee. *See* Trustee’s Memorandum of Law in Opposition to Motion by Defendants Ariel Fund Ltd. and Gabriel Capital L.P. to Dismiss the Second

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Amended Complaint, p. 41-42 (the “Trustee’s Memo,” a copy of which is attached as Exhibit G to the Scott Decl.). However, the plain language of SIPA is contrary to this interpretation. SIPA provides that a SIPA trustee may employ the avoidance provisions only “if and to the extent that [a] transfer is voidable or void under the provisions of title 11.” 15 U.S.C. § 78fff-2(c)(3). The Trustee’s Complaint requires an unprecedented, expanded reading of SIPA that conflicts with the Bankruptcy Code and with non-SIPA securities law. Such an interpretation mandates withdrawal of the reference.

**II. THE TRUSTEE’S ARGUMENT THAT SIPA NEGATES BANKRUPTCY CODE SECTION 546(E) WARRANTS WITHDRAWING THE REFERENCE**

Section 546(e) of the Bankruptcy Code sets limitations on the Trustee’s ability to avoid certain transfers. *See* 11 U.S.C. § 546(e). Recognizing that he cannot proceed with his constructive fraudulent conveyance claim against the Funds if this “safe harbor” provision applies, the Trustee has argued that SIPA overrides Section 546(e) here. *See* Trustee’s Memo p. 35-36. Since resolution of this issue requires an interpretation of SIPA that is inconsistent with the Bankruptcy Code, withdrawal of the reference is mandated. *See HSBC*, 460 B.R. at 413 (holding that a conflict between SIPA and bankruptcy law “warrants withdrawal of the bankruptcy reference”).

Section 546(e) of the Code provides that a “trustee may not avoid a transfer . . . that is a transfer made by or to . . . [a] stockbroker [or] financial institution . . . in connection with a securities contract . . . .” *Id.* Section 546(e) is one of several Bankruptcy Code provisions that provide a wide range of safe harbors that balance the avoidance powers with the need to protect the securities and financial markets from disruption. However, Section 546(e) does not apply to insulate an actual fraudulent conveyance made within two years of a bankruptcy filing unless the recipient received the transfer in good faith and for “value.”

Section 741(7) defines the term “securities contract” broadly to include “a contract for the purchase [or] sale ... of a security ..., including an option to purchase or sell any security.” 11 U.S.C. § 741(7)(A)(i). Further, the term “settlement payment,” which also is defined broadly, includes “any payment in settlement of a securities transaction.” *In re Enron Creditors Recovery Corp.*, 422 B.R. 423, 433-434 (S.D.N.Y. 2009); 11 U.S.C. § 741(8). *See, generally, In re Stewart Finance Co.*, 367 B.R. 909, 917 (Bankr. M.D. Ga. 2007) (“As suggested by this definition, the term ‘settlement payment’ should be interpreted very broadly.”).<sup>3</sup> Finally, the Bankruptcy Code defines the term “stockbroker” as a person “with respect to which there is a customer” and “that is engaged in the business of effecting transactions in securities for the account of others ...,” 11 U.S.C. § 101(53A), and the term “financial institution” as “an entity that is a commercial or savings bank ...” 11 U.S.C. § 101(22). Applying the plain language of these sections here, it is clear that all of the elements of Section 546(e) are satisfied, and therefore this section of the Bankruptcy Code serves as a complete bar to the Trustee’s constructive fraudulent conveyance claims against the Funds.

First, BLMIS was, and must have been, a “broker” within the meaning of Section 546(e) because, among other things, it is the subject of a SIPA proceeding. Only a registered broker qualifies as a candidate for a SIPA proceeding. *See* 15 U.S.C. § 78ccc(a)(2)(A) (defining SIPC members as registered brokers or dealers under the federal securities laws). If BLMIS was a broker under applicable law when it engaged in the targeted transfers and was a broker for purposes of a SIPA liquidation, to conclude that BLMIS is not a broker for purposes of the

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<sup>3</sup> Notably, the *Enron Creditors Recovery* court recognized that “section 741(8) does not limit the definition of ‘settlement payment’ to payments ‘commonly used in the securities trade.’ ” 422 B.R. at 430.

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Bankruptcy Code safe harbor in a SIPA case creates a mystifying conflict among SIPA, the securities laws, and the Bankruptcy Code.

In addition, as even the Trustee concedes in his Complaint, BLMIS and the Funds “executed a Customer Agreement, an Option Agreement, and a Trading Authorization Limited to Purchases and Sales of Securities and Options” for purposes of “securities trading activities.” Complaint at ¶¶ 38-39. The Trustee alleges further that “Defendants consistently wired funds to the BLMIS Bank Account in New York, New York for application to the Account[s] and the conducting of trading activities.” *Id.* at ¶ 39. Thus, it is beyond dispute that the Transfers were made in connection with a “securities contact” as contemplated by Section 546(e). It also cannot be disputed that JP Morgan Chase, the bank from which BLMIS wired the Transfers to the Funds, is a “financial institution.” Accordingly, all of Section 546(e)’s requirements are satisfied here.

Nevertheless, the Trustee has maintained in the Adversary Proceeding that application of Section 546(e) is “inconsistent with SIPA and inapplicable here” because it would allow the Funds “to circumvent one of the core foundations of the Bankruptcy Code and SIPA – that is, the equitable distribution of assets of all similarly-situated creditors.” *See* Trustee’s Memo, p. 33-34, 36. In fact, the Trustee maintains that permitting the Funds to benefit from the protections afforded by Section 546(e) “would run afoul of the equitable principles underlying SIPA ...[by] significantly diminish[ing] the assets available to the Trustee for equitable distribution to *all* customers of BLMIS who were harmed by the fraud.” *Id.* at p. 34. This novel interpretation of

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SIPA which directly conflicts with the Bankruptcy Code warrants withdrawing the Bankruptcy Court reference. *See HSBC*, 450 B.R. at 412.<sup>4</sup>

Notably, the District Court recently found that it was required to withdraw the reference in *Picard v. Katz* to resolve this precise issue – *i.e.*, whether SIPA limits the applicability of Section 546(e) in an adversary proceeding brought by the Trustee. *See Picard v. Katz*, No. 11 Civ. 3605, 2011 WL 7267859, at \*1 (S.D.N.Y. July 5, 2011) (referencing the Court’s July 1, 2011 hearing). In so doing, the Court found that resolution of this issue involved “material and unresolved issues of non-bankruptcy federal law.” *Id.* Accordingly, the *Katz* court withdrew the reference.<sup>5</sup>

The District Court likewise found that it was required to withdraw the reference in *Picard v. Flinn Investments, LLC*, to decide whether Section 546(e) limits the Trustee’s ability to avoid transfers. 463 B.R. 280, 285 (S.D.N.Y. 2011). Indeed, the *Flinn* court agreed that whether Section 546(e) applies depends on how a Court resolves numerous questions of securities law, including, “whether transfers from Madoff Securities completed securities transactions even though Madoff Securities never purchased or sold securities on these defendants’ behalves.” 463 B.R. at 285. The Court held that making this determination requires a “*significant interpretation*” of securities law. *Id.* (emphasis added) In addition, the Court found that the

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<sup>4</sup> The Bankruptcy Court previously has held that application of Section 546(e) to a BLMIS adversary proceeding was “incompatible with SIPA” and, therefore, SIPA controls and Section 546(e) cannot apply. *Picard v. Merkin*, 440 B.R. 243, 267-68 (Bankr. S.D.N.Y. 2010).

<sup>5</sup> Thereafter, on September 1, 2011, Judge Rakoff granted, in part, the *Katz* defendants’ motion to dismiss, finding that: (i) Section 546(e)’s safe harbor for settlement payments and transfers made in connection with securities contract barred the Trustee from proceeding with claims to recover monies paid by BLMIS to its customers, except in cases of actual fraud; (ii) prepetition transfers by BLMIS could not be avoided as actual fraudulent transfers, absent bad faith on part of customers, to the extent that customers invested principal with, and thus gave value to, BLMIS; and (iii) SIPA barred the Trustee’s disallowance claims. *See Picard v. Katz*, 462 B.R. 447 (S.D.N.Y. 2011).

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phrase, “in connection with,” as used in Section 546(e) to discuss securities contracts, is not defined in the Bankruptcy Code, and therefore application of the phrase also requires novel and significant interpretation of the securities law. *Id.* at 285-286. Accordingly, the Court withdrew the reference to decide the question of Section 546(e)’s application in a SIPA proceeding. *Id.* at 286.

The District Court’s reasoning in *Katz* and *Flinn* is sound. Accordingly, the same result is warranted here.

### **III. THE INTERPRETATION OF SIPA TO AUTHORIZE THE AVOIDANCE OF PRINCIPAL PAYMENTS TO BLMIS CUSTOMERS FURTHER REQUIRES WITHDRAWING THE REFERENCE**

As this Court is well aware, under the Bankruptcy Code, certain transfers occurring prior to a bankruptcy filing may be avoided either as fraudulent or as preferential transfers. Of relevance here, a transfer is intentionally fraudulent when the debtor “intends to hinder and delay [its creditors] *as a class.*” *Van Iderstine v. Nat’l Discount Co.*, 227 U.S. 575, 582 (1913) (emphasis added). A transfer that has the same result, even if not intentional, is avoidable as constructively fraudulent. “Fraudulent transfers are avoidable because they diminish the assets of the debtor to the detriment of *all creditors.*” *In re Chase & Sanborn Corp.*, 813 F.2d 1177, 1181 (11th Cir. 1987) (emphasis added). Nevertheless, the trustee cannot avoid transfers made for “value” and received in “good faith.”

In the context of redemption payments received by an investor of less than its principal investment from an entity operating a fraudulent Ponzi scheme, “value” for such payment is sufficiently established because the investors holds a tort claim for rescission to recover 100% of the amount of its investment based on the pervasive and continuing fraud that induced its investment. *In re Bayou Group, LLC*, 396 B.R. 810, 844 (Bankr. S.D.N.Y. 2008); *see also Donell v. Kowell*, 533 F. 3d 762, 772 (9th Cir. 2008), *cert. denied Kowell v. Donell*, 129 S.Ct.

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640 (2008) (“Payments up to the amount of the initial investment are considered to be exchanged for ‘reasonably equivalent value,’ and thus not fraudulent, because they proportionally reduce the investors’ right to restitution.”). It is undisputed here that the Funds did not withdraw any amounts in excess of their investments, so there can be no argument that the Funds received false profits. To the contrary, the Funds withdrew less than 10% of the amount they invested.

Moreover, by definition, a transfer to a creditor that discharges a valid debt – such as BLMIS’ transfers to customers – cannot be avoided as fraudulent. As the Second Circuit consistently has recognized, “the preferential repayment of pre-existing debts to some creditors does not constitute a fraudulent conveyance, whether or not it prejudices other creditors, because ‘the basic object of fraudulent conveyance law is to see that the debtor uses his limited assets to satisfy *some* of his creditors; it normally does not try to choose among them.’” *HBE Leasing Corp. v. Frank*, 48 F.3d 623, 634 (2d Cir. 1995) (quoting *Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1509 (1st Cir. 1987)); *see also In re Sharp Int’l Corp.*, 403 F.3d 43, 54 (2d Cir. 2005) (“[A] conveyance which satisfies an antecedent debt made while the debtor is insolvent is neither fraudulent nor otherwise improper, even if its effect is to prefer one creditor over another.” (quoting *Ultramar Energy Ltd. v. Chase Manhattan Bank, N.A.*, 191 A.D. 2d 86, 90-91, 599 N.Y.S. 2d 816 (1st Dep’t 1993))).

For example, in *In re Sharp International Corp.*, 403 F. 3d 43 (2d Cir. 2005), the Second Circuit expressly held that a transfer made to satisfy an antecedent obligation to the debtor’s lender was not a fraudulent conveyance. In *Sharp*, the debtor sued one of its former lenders to recover a prepetition loan repayment the debtor made to the lender as, *inter alia*, an intentional fraudulent conveyance. The debtor argued that although it was current in its loan repayments to the lender, the lender arranged to have the debtor’s principals repay the lender’s loan, after the

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lender began to suspect fraud, from the proceeds of new loans from unsuspecting lenders. The debtor thereafter obtained an additional \$25 million in financing from its noteholders and used those funds to pay the lender approximately \$12.25 million. Notably, the complaint alleged that the lender “gave no warnings and blew no whistles” and “ignored inquiring calls from the Noteholders.” *Id.* at 48.

On appeal from the district court’s decision affirming the bankruptcy court’s dismissal of the complaint, the Second Circuit found that “[t]he \$12.25 million payment was at most a preference between creditors and did not ‘hinder, delay, or defraud either present or future creditors.’” *Id.* at 56 (citing NYDCL § 276). In so holding, the Court recognized that “[a] conveyance which satisfies an antecedent debt made while the debtor is insolvent is neither fraudulent nor otherwise improper, even if its effect is to prefer one creditor over another.” *Id.* at 54-55. Importantly, the *Sharp* court held that although the essence of the complaint was that the lender “knew that there would likely be victims of the [principals]’ fraud, and arranged not to be among them” – which the court suggested was “repugnant” – the Court nevertheless concluded that “[t]he moral analysis contribute[d] little” and affirmed the dismissal. *Id.* at 52.

The Trustee does not dispute this proposition. The rationale articulated by the Trustee for avoiding the Transfers, however, is that the Funds did not, in fact, have tort claims against BLMIS since they allegedly were aware of the fraud. *See* Trustee’s Memo, p. 12-14. Consideration of this issue – *i.e.*, whether the Funds held tort claims against BLMIS under applicable securities laws – necessarily requires that the Court engage in significant interpretation of non-bankruptcy law, and warrants withdrawing the reference. Recently, in *Flinn*, the District Court agreed with the proposition propounded here by the Funds and found that, “[r]esolution of the issues this argument raises requires ‘significant interpretation’ of the

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securities laws,” and therefore “withdr[ew] the reference to the bankruptcy court in order to undertake the ‘significant interpretation’ of securities law necessary to resolve it.” 463 B.R. at 285 (withdrawing the reference to determine whether BLMIS customer had rescission claim that was satisfied by transfer under applicable securities laws).

The District Court also should withdraw the reference of the Adversary Proceeding to determine whether the Funds acted in “good faith” when they received the Transfers. The standard applicable in bankruptcy avoidance actions is whether the defendant was on “inquiry notice” of the fraud, but nevertheless failed to diligently investigate. *See, e.g. In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 22-23 (S.D.N.Y. 2007); *In re Bayou Group, LLC*, 439 B.R. 284, 309 (S.D.N.Y. 2010). This Court found in another BLMIS-related adversary proceeding that the standard for “good faith” in a SIPA case, however, is not inquiry notice, but instead “willful blindness,” a much higher hurdle for the Trustee. *Picard v. Katz*, 462 B.R. 447, 455-456. Specifically, the Court held that an investor “has no inherent duty to inquire about his stockbroker” but that if an investor “intentionally chooses to blind himself to the ‘red flags’ that suggest a high probability of fraud, his ‘willful blindness’ . . . is tantamount to a lack of good faith.” *Id.* at 455. Nothing in the allegations in the Complaint suggests that the Trustee can prove willful blindness in this case. In any event, the Receiver submits that the District Court should withdraw the reference to consider whether the willful blindness standard applies for purposes of determining the Funds’ good faith.

#### **IV. ALLOWING THE ADVERSARY PROCEEDING TO REMAIN IN BANKRUPTCY COURT RAISES CONSTITUTIONAL ISSUES**

Withdrawal of the reference is also warranted because, in light of the Supreme Court’s recent decision in *Stern v. Marshall*, 131 S.Ct. 2594 (June 23, 2011), there is now a serious

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question as to whether the Bankruptcy Court can constitutionally decide this Adversary Proceeding.

In *Stern*, the Supreme Court held that a counterclaim asserted by Vickie Marshall as debtor in possession was a core claim as defined in 28 U.S.C. § 157(b)(2) because it came within the category enumerated in section 157(b)(2)(C) – *i.e.*, “counterclaims by the estate against persons filing claims against the estate.” 131 S.Ct. at 2596. The Court nonetheless held that permitting a bankruptcy court to hear and determine the counterclaim would violate Article III of the Constitution because a bankruptcy court is not an Article III court and the counterclaim did not involve a “public right” that may be adjudicated by a non-Article III court. The Court held that the assertion of core jurisdiction under section 157(b)(2)(C), although in accord with the statute, was unconstitutional because the debtor’s “claim is a state law action independent of the federal bankruptcy law and not necessarily resolved by a ruling on the creditor’s proof of claim in bankruptcy.” 131 S.Ct. at 2611.

The Supreme Court also implied that fraudulent conveyance claims like those asserted in the Adversary Proceeding may not be heard by a Bankruptcy Court. Although the Court declined to rule on whether fraudulent conveyance claims may be decided by a non-Article III court in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), the *Stern* Court nevertheless relied on that decision as demonstrating the nature of the claims that may not be decided by a non-Article III court. In explaining why Vickie Marshall’s counterclaim could not be decided by a non-Article III court, Chief Justice Roberts explained:

In *Granfinanciera* we rejected a bankruptcy trustee’s argument that a fraudulent conveyance action filed on behalf of a bankruptcy estate against a noncreditor in a bankruptcy proceeding fell within the “public rights” exception. We explained that, “[i]f a statutory right is not closely intertwined with a federal regulatory program Congress has power to enact, and if that right neither belongs to nor exists against the Federal Government, then it must be adjudicated by an Article

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III court.” *Id.* at 54-55. We reasoned that fraudulent conveyance suits were “quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors’ hierarchically ordered claims to a pro rata share of the bankruptcy res.” *Id.* at 56. As a consequence, we concluded that fraudulent conveyance actions were “more accurately characterized as a private rather than a public right as we have used those terms in our Article III decisions.” *Id.* at 55.

Vickie’s counterclaim—like the fraudulent conveyance claim at issue in *Granfinanciera*—does not fall within any of the varied formulations of the public rights exception in this Court’s cases.

131 S.Ct. at 2614.

The Court’s recognition that the distinction between public and private rights that it applied in *Granfinanciera* is determinative of whether a case can be decided by a bankruptcy court supports the conclusion that this entire Adversary Proceeding should be heard by the District Court. The presumption in favor of Article III courts clearly articulated by the majority in *Stern* weighs heavily in favor of immediate withdrawal of the reference of this Adversary Proceeding to the District Court for all purposes.

The District Court recently withdrew the reference in the Trustee’s action against Flinn Investments for this reason. *Flinn*, 463 B.R. at 287. The Court concluded that determining whether the final resolution of claims to avoid transfers as fraudulent requires an exercise of “judicial Power,” reserved for Article III courts, will require “significant interpretation” of both Article III and Supreme Court precedent. *Id.* at 287-288. As such, the Court withdrew the reference for the purpose of determining whether the bankruptcy court lacks the requisite “judicial Power” and “whether, if the bankruptcy court cannot finally resolve the fraudulent transfer claims in *Flinn*, it has the authority to render findings of fact and conclusions of law before final resolution.” *Id.* at 288.<sup>6</sup> The same result should apply here.<sup>7</sup>

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<sup>6</sup> The District Court has not yet rendered a decision on this issue.

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### CONCLUSION

For the reasons set forth above, this Adversary Proceeding should be heard the District Court for all purposes. Accordingly, it is respectfully submitted that the Withdrawal Motion should be granted.

Dated: April 2, 2012  
New York, New York

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*Attorneys for Bart M. Schwartz, as  
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Continued from previous page

<sup>7</sup> The Receiver recently learned that, on March 28, 2012, Judge Rakoff directed the Trustee to prepare a consent order, *inter alia*, granting all currently pending motions to withdraw the reference in order to address *Stern v. Marshall* issues. The Receiver will proceed in accordance with any such order in connection with *Stern v. Marshall* issues.

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L.P.*

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

SECURITIES INVESTOR PROTECTION  
CORPORATION,

Plaintiff,

v.

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

Adv. Pro. No. 08-01789 (BRL)

SIPA Liquidation

(Substantively Consolidated)

In re:

BERNARD L. MADOFF,

Debtor.

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

Plaintiff,

v.

J. EZRA MERKIN, GABRIEL CAPITAL, L.P.,  
ARIEL FUND LTD., ASCOT PARTNERS, L.P.,  
GABRIEL CAPITAL CORPORATION,

Defendants.

Adv. Pro. No. 09-01182 (BRL)

**JOINDER OF DAVID B. PITOFSKY, AS RECEIVER FOR DEFENDANT  
ASCOT PARTNERS L.P., TO THE MOTION OF BART M. SCHWARTZ,  
AS RECEIVER OF DEFENDANTS ARIEL FUND LIMITED AND  
GABRIEL CAPITAL, L.P., TO WITHDRAW THE REFERENCE**

David B. Pitofsky, Esq., as Receiver (the “Receiver”) for defendant Ascot Partners L.P. (“Ascot”),<sup>1</sup> by his attorneys, Goodwin Procter LLP, respectfully joins in the Motion of Bart M. Schwartz, As Receiver of Defendants Ariel Fund Limited and Gabriel Capital, L.P., to Withdraw the Reference, filed on April 2, 2012 (Adv. Pro. Dkt. No. 119) and the concurrently filed memorandum of law and declaration in support thereof (Adv. Pro. Dkt. Nos. 120 and 121) (together, the “Schwartz Motion”). The Complaint in the within adversary proceeding raises issues as to Ascot substantially similar to those addressed in the Schwartz Motion that this Court has determined, in similar cases, require consideration of title 11 and substantial and material consideration of federal non-bankruptcy law.

**Background**

1. Ascot Fund Ltd. (“Ascot Fund”) opened an account in 1992 and Ascot opened a BLMIS account in 1993. In 2003, Ascot Fund transferred its account balance to the account held by Ascot in exchange for a limited partnership interest in Ascot. Over the life of Ascot’s account, approximately \$560 million was deposited in the account; however, the Trustee asserts that the transfers included \$335 million in fictitious profits embedded in the transferred accounts, leaving net cash deposited of approximately \$226 million. *See* Exhibits B and C to

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<sup>1</sup> On April 6, 2009, the New York State Attorney General filed a Summons and Complaint against J. Ezra Merkin (“Merkin”) and Gabriel Capital Corporation (“GCC” and together with Merkin, the “Merkin Defendants”) in the Supreme Court of the State of New York, New York County in the case of *People of the State of New York v. J. Ezra Merkin et al.* (Civ. No. 450879/2009) (Lowe, J.S.C.). The Summons and Complaint also named, among other entities, Ascot, Ariel Fund Limited (“Ariel”) and Gabriel Capital, L.P. (“Gabriel”) as defendants (the “Funds”). The Summons and Complaint seek, among other things, an accounting of transfers to the Funds. David Pitofsky is the Court-appointed Receiver for Ascot pursuant to a Stipulation and Order Appointing the Receiver dated July 14, 2009.



3. The Defendants held a BLMIS account in the name of “Ascot Partners LP.” See Exhibit A to Amended Complaint. Ascot was among those determined by the Trustee to be “customers with claims for securities within the meaning of SIPA.” *In re Bernard L. Madoff Investment Securities LLC*, 654 F.3d 229, 233 (2d Cir. 2011).

4. On December 17, 2010, Ascot filed its Answer to the Amended Complaint (Adv. Pro. Dkt. No. 96). The Trustee and the Funds are currently engaged in discovery.

### Argument

5. Withdrawal of the reference of a proceeding that meets the terms of the second sentence of 28 U.S.C. § 157(d) is mandatory:

The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

6. For the reasons set forth in the Schwartz Motion, and because the issues raised in the Schwartz Motion are equally applicable to Ascot, the Receiver submits that the reference should be withdrawn as to the following issues:

(a) Whether the debt of BLMIS to its customer under non-bankruptcy securities laws constitutes antecedent debt to the customer, such that payment to the customer discharges antecedent debt and provides a customer who took that payment in good faith with a complete defense to a claim that the payment was a fraudulent transfer (the “Antecedent Debt Issue”).<sup>3</sup>

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<sup>3</sup> The Court granted partial summary judgment to the Trustee in *Katz*, ruling that transfers made to customers in excess of their investment were not on account of an antecedent debt constituting value for the purposes of Section 548(c). Order dated March 5, 2012 (*Katz* Dkt. No.142). However, as a result of the settlement in *Katz* on March 19, 2012, that Order did not become a final order subject to appellate review. The Defendants reserve their rights to raise this issue pending further order of the Court in this or another case.

(b) Whether payments to customers by BLMIS, a registered stockbroker and a debtor in a SIPA proceeding open only to registered brokers, are within the statutory “safe-harbor” of Section 546(e) of the Bankruptcy Code that protects from avoidance (except under section 548(a)(1) of the Bankruptcy Code) “settlement payments” made by a stockbroker “in connection with a securities contract” (the “546(e) Issue”).

(c) Whether SIPA and other securities laws alter the standard the Trustee must meet in order to show that a defendant did not receive transfers in “good faith” under section 548(c), and, if so, whether the applicable duty of inquiry of a stockbroker’s customer requires that the Trustee show that a defendant was “willfully blind” in order to establish a lack of good faith (the “Good Faith Issue”).

(d) Whether, after the United States Supreme Court’s decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011), final resolution of claims to avoid transfers as fraudulent requires an exercise of “judicial Power” reserved for Article III courts, preventing the bankruptcy court from finally resolving such claims, and, if the bankruptcy court cannot finally resolve the fraudulent transfer claims, it has the authority to render findings of fact and conclusions of law before final resolution (the “Stern v. Marshall Issue”).



**CERTIFICATE OF SERVICE**

I, hereby certify that on April 2, 2012, I caused a true and correct copy of the forgoing to be served by electronic means, via the Court's CM/ECF system, on all counsel registered to receive electronic notices. I also certify that I have caused copies of the aforementioned document to be served via first class mail, postage prepaid upon the non-CM/ECF participants indicated in the Notice of Electronic Filing.

/s/ Daniel M. Glosband  
Daniel M. Glosband

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UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

----- X  
In re: :  
: :  
BERNARD L. MADOFF INVESTMENT :  
SECURITIES LLC, :  
: :  
Debtor. : X

SIPA LIQUIDATION  
No. 08-01789 (BRL)

-----  
IRVING H. PICARD, Trustee for the Liquidation :  
of Bernard L. Madoff Investment Securities LLC, :  
: :  
Plaintiff, :  
: :  
v. :  
: :  
J. EZRA MERKIN, GABRIEL CAPITAL, L.P., :  
ARIEL FUND LTD., ASCOT PARTNERS, L.P., :  
GABRIEL CAPITAL CORPORATION, :  
: :  
Defendants. :  
----- X

Adv. Proc. No. 09-01182 (BRL)

**MEMORANDUM OF LAW IN SUPPORT OF MOTION OF DEFENDANTS  
J. EZRA MERKIN AND GABRIEL CAPITAL CORPORATION TO  
WITHDRAW THE REFERENCE TO THE BANKRUPTCY COURT**

**A-637**

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Defendants J. Ezra Merkin (“Merkin”) and Gabriel Capital Corporation (“GCC,” and collectively the “Merkin Defendants”), respectfully submit this memorandum of law and the accompanying declaration of Neil A. Steiner, dated April 2, 2012 (the “Steiner Decl.”), in support of Merkin and GCC’s motion to the United States District Court for the Southern District of New York (the “District Court” or “this Court”), pursuant to 28 U.S.C. § 157(d), Rule 5011(a) of the Federal Rules of Bankruptcy Procedure, and Rule 5011-1 of the Local Rules of the Bankruptcy Court, for an order withdrawing the reference to the Bankruptcy Court of this action filed by plaintiff Irving Picard (the “Trustee”), as Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC (“BLMIS”).

#### **Preliminary Statement**

In this action, the Trustee of BLMIS, appointed under the Securities Investor Protection Act (“SIPA”), 15 U.S.C. § 78aaa *et seq.*, seeks to recover from the Merkin Defendants unspecified transfers allegedly made to them by defendants Gabriel Capital, L.P. (“Gabriel Fund”), Ariel Fund Ltd. (“Ariel Fund”), Ascot Partners, L.P. (“Ascot Partners,” and together with Gabriel Capital and Ariel Fund, the “Funds”) of amounts the Funds had received in redemptions from Madoff. The Funds were net losers of more than \$550 million in unredeemed principal investment with BLMIS. The Trustee acknowledges in the Second Amended Complaint that the Funds invested more than \$1 billion with BLMIS, never came close to redeeming the amount of their principal investment and in fact lost at least \$435 million of unredeemed *principal investment* when Madoff’s massive Ponzi scheme was revealed. Indeed, the Funds believed based on the account statements issued by BLMIS that the total value of their BLMIS accounts as of November 30, 2008, was more than \$2.4 billion, and the Merkin

Defendants personally believed that they had more than \$110 million invested with BLMIS through their investments in the Funds.

The Merkin Defendants have not filed a proof of claim in the SIPA liquidation of BLMIS, and therefore are entitled to a jury trial on the Trustee's claims against them. The Merkin Defendants do not consent to a jury trial before the Bankruptcy Court. Moreover, the Bankruptcy Court lacks jurisdiction to enter final judgment on the Trustee's claims. The interests of judicial efficiency and uniformity support permissive withdrawal of the reference for this entire case "for cause shown." Withdrawal of the reference at the time of trial would avoid piecemeal litigation and the unnecessary expenditure of time and money that would be required if this action were to proceed in two courts. Consistent with the interest of judicial efficiency, the Bankruptcy Court may continue to oversee discovery, resolve discovery disputes and issue a Report and Recommendation on the Merkin Defendants' anticipated motion for summary judgment.<sup>1</sup>

### **Background**

The Trustee filed a Complaint on May 6, 2009, an Amended Complaint on August 6, 2009, and a Second Amended Complaint on December 23, 2009, seeking to avoid and recover alleged preferential and fraudulent transfers made to or for the benefit of the Defendants as initial or subsequent transferees under Sections 544, 547, 548, 550, and 551 of the Bankruptcy Code and various sections of the NYDCL. The Second Amended Complaint also seeks to recover certain transfers under state partnership law from Merkin as general partner of Ascot, to disallow the Fund Defendants' SIPA claims, and to obtain turnover and accounting under section 542 of

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<sup>1</sup> In the event the Court withdraws the reference based on any additional ground asserted by any Fund Defendant in the action, withdrawal of the reference with respect to the same or interrelated claims asserted against the Merkin Defendants would also be appropriate and would promote judicial efficiency and uniformity.

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the Code and SIPA section 78fff-2(c)(3). (*See* Second Amended Complaint, Steiner Decl., Ex. A.)

On January 25, 2010, the Merkin Defendants moved to dismiss the Second Amended Complaint for failure to state a claim. The Bankruptcy Court denied that motion on November 17, 2010. (*See* Order of November 17, 2010, Steiner Decl., Ex. B.) Since then, the parties have engaged in extensive discovery. Fact discovery is currently scheduled to end July 2, 2012, with expert discovery to be completed by October 15, 2012. Motions for summary judgment are due December 14, 2012, with responses due January 25, 2013, and replies February 15, 2013. (*See* Second Amended Case Management Order of January 31, 2012, Steiner Decl., Ex. C.) In light of the Bankruptcy Court's Order that all motions for withdrawal of the reference in this matter be filed on or before April 2, 2012, the Merkin Defendants respectfully file this motion to withdraw the reference at this time, to preserve their right to a trial by jury.

#### **Argument**

District Courts have original jurisdiction over cases “arising under title 11, or arising in or related to cases under title 11.” 28 U.S.C. § 1334(b). District Courts are, however, permitted to refer cases or proceedings within that jurisdiction to bankruptcy judges. 28 U.S.C. § 157(a). In this District, a standing order provides for the automatic reference of such matters to the Bankruptcy Court. Nevertheless, Congress has provided that a District Court may, and in certain circumstances is required to, withdraw that reference:

The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

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28 U.S.C. § 157(d). The decision to withdraw the reference is made by the District Court, not the Bankruptcy Court. Fed. R. Bankr. P. 5011(a) (2011) (“A motion for withdrawal of a case of proceeding shall be heard by a district judge.”); Fed. R. Bankr. P. 5011 advisory committee’s note (“The withdrawal decision is committed exclusively to the district court.”).

The factors to be considered include the efficient use of judicial resources and delay and costs to the parties. *See, e.g., In re Orion Pictures Corp.*, 4 F.3d 1095, 1101 (2d Cir. 1993); *In re Nw. Airlines Corp.*, 384 B.R. 51, 59 (S.D.N.Y. 2008) (“[T]he critical question is efficiency and uniformity.” (alteration in original; quotations omitted)). For the reasons set forth below, this Court should withdraw the reference at the time of trial as to the Merkin Defendants “for cause shown.”

Withdrawal of the reference for trial in the District Court is required here. The Merkin Defendants have not filed a proof of claim in the SIPA liquidation of BLMIS. Accordingly, the Merkin Defendants are entitled to a jury trial on the Trustee’s claim against them. *See Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 36, 58 (1989); *see also Stern v. Marshall*, 131 S. Ct. 2594 (2011). The Bankruptcy Court may only hold a jury trial if it is “specially designated” to do so by the District Court and if it has “the express consent of all the parties.” 28 U.S.C. § 157(e). In addition, while Bankruptcy Court may issue a Report and Recommendation on the Merkin Defendants’ anticipated motion for summary judgment, it cannot enter a final judgment in this action. Because the Merkin Defendants have demanded a jury trial in their Answer and do not consent to a jury trial in the Bankruptcy Court, in the event any part of this action remains against the Merkin Defendants following their motion for summary judgment, this action will be tried in the District Court. However, because discovery is ongoing before the Bankruptcy Court, the Merkin Defendants respectfully request that discovery continue to proceed as scheduled in

the Bankruptcy Court and that the Bankruptcy Court consider and issue a Report and Recommendation on the Merkin Defendants' anticipated motion for summary judgment motion.

**Conclusion**

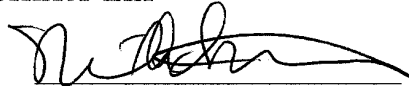
For the foregoing reasons, the Merkin Defendants respectfully request that the District Court enter an order withdrawing from the Bankruptcy Court the reference of this action for the purpose of any trial herein.

Dated: New York, New York  
April 2, 2012

Respectfully submitted,

**DECHERT LLP**

By:



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# **EXHIBIT G**

A-645

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STANTON, J.

 ORIGINAL

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UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, )  
)  
Plaintiff, )  
v. )  
)  
BERNARD L. MADOFF, and )  
BERNARD L. MADOFF INVESTMENT )  
SECURITIES LLC, )  
Defendants. )

Civ. 08-10791

\_\_\_\_\_  
SECURITIES INVESTOR PROTECTION CORPORATION, )  
)  
Applicant, )  
v. )  
)  
BERNARD L. MADOFF INVESTMENT )  
SECURITIES LLC, )  
Defendant. )

ORDER

On the Complaint and Application of the Securities Investor Protection Corporation ("SIPC"), it is hereby:

I. ORDERED, ADJUDGED and DECREED that the customers of the Defendant,

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Bernard L. Madoff Investment Securities LLC, are in need of the protection afforded by the Securities Investor Protection Act of 1970, as amended ("SIPA", 15 U.S.C. §78aaa *et seq.*).

II. ORDERED that pursuant to 15 U.S.C. §78eee(b)(3), Irving H. Picard, Esquire is appointed trustee for the liquidation of the business of the Defendant with all the duties and powers of a trustee as prescribed in SIPA, and the law firm of Baker & Hostetler LLP is appointed counsel for the trustee. The trustee shall file a fidelity bond satisfactory to the Court in the amount of

✓ \$ 250,000.00

LLS

III. ORDERED that all persons and entities are notified that, subject to the other provisions of 11 U.S.C. §362, the automatic stay provisions of 11 U.S.C. §362(a) operate as a stay of:

- A. the commencement or continuation, including the issuance or employment of process, of a judicial, administrative or other proceeding against the Defendant that was or could have been commenced before the commencement of this proceeding, or to recover a claim against the Defendant that arose before the commencement of this proceeding;
- B. the enforcement against the Defendant or against property of the estate of a judgment obtained before the commencement of this proceeding;
- C. any act to obtain possession of property of the estate or property from the estate;
- D. any act to create, perfect or enforce any lien against property of the estate;
- E. any act to create, perfect or enforce against property of the Defendant any lien to the extent that such lien secures a claim that arose before the commencement of this proceeding;
- F. any act to collect, assess or recover a claim against the Defendant that arose before the commencement of this proceeding;
- G. the setoff of any debt owing to the Defendant that arose before the commencement

of this proceeding against any claim against the Defendant; and

H. the commencement or continuation of a proceeding before the United States Tax Court concerning the Defendant's tax liability for a taxable period the Bankruptcy Court may determine.

IV. ORDERED that all persons and entities are stayed, enjoined and restrained from directly or indirectly removing, transferring, setting off, receiving, retaining, changing, selling, pledging, assigning or otherwise disposing of, withdrawing or interfering with any assets or property owned, controlled or in the possession of the Defendant, including but not limited to the books and records of the Defendant, and customers' securities and credit balances, except for the purpose of effecting possession and control of said property by the trustee.

V. ORDERED that pursuant to 15 U.S.C. §78eee(b)(2)(B)(i), any pending bankruptcy, mortgage foreclosure, equity receivership or other proceeding to reorganize, conserve or liquidate the Defendant or its property and any other suit against any receiver, conservator or trustee of the Defendant or its property, is stayed.

VI. ORDERED that pursuant to 15 U.S.C. §§78eee(b)(2)(B)(ii) and (iii), and notwithstanding the provisions of 11 U.S.C. §§362(b) and 553, except as otherwise provided in this Order, all persons and entities are stayed, enjoined and restrained for a period of twenty-one (21) days, or such other time as may subsequently be ordered by this Court or any other court having competent jurisdiction of this proceeding, from enforcing liens or pledges against the property of the Defendant and from exercising any right of setoff, without first receiving the written consent of SIPC and the trustee.

VII. ORDERED that, pursuant to 15 U.S.C. §78eee(b)(2)(C)(ii), and notwithstanding 15 U.S.C. §78eee(b)(2)(C)(i), all persons and entities are stayed for a period of twenty-one (21) days,

or such other time as may subsequently be ordered by this Court or any other court having competent jurisdiction of this proceeding, from foreclosing on, or disposing of, securities collateral pledged by the Defendant, whether or not with respect to one or more of such contracts or agreements, securities sold by the Defendant under a repurchase agreement, or securities lent under a securities lending agreement, without first receiving the written consent of SIPC and the trustee.

VIII. ORDERED that the stays set forth above shall not apply to:

- A. any suit, action or proceeding brought or to be brought by the United States Securities and Exchange Commission ("Commission") or any self-regulatory organization of which the Defendant is now a member or was a member within the past six months; or
- B. the exercise of a contractual right of a creditor to liquidate, terminate, or accelerate a securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, or master netting agreement, as those terms are defined in 11 U.S.C. §§101, 741, and 761, to offset or net termination values, payment amounts, or other transfer obligations arising under or in connection with one or more of such contracts or agreements, or to foreclose on any cash collateral pledged by the Defendant, whether or not with respect to one or more of such contracts or agreements; or
- C. the exercise of a contractual right of any securities clearing agency to cause the liquidation of a securities contract as defined in 11 U.S.C. §741(7); or
- D. the exercise of a contractual right of any stockbroker or financial institution, as defined in 11 U.S.C. §101, to use cash or letters of credit held by it as collateral, to cause the liquidation of its contract for the loan of a security to the Defendant or

for the pre-release of American Depository Receipts or the securities underlying such receipts; or

E. the exercise of a contractual right of any “repo” participant, as defined in 11 U.S.C. §101, to use cash to cause the liquidation of a repurchase agreement, pursuant to which the Defendant is a purchaser of securities, whether or not such repurchase agreement meets the definition set forth in 11 U.S.C. §101(47); or

F. the exercise of a contractual right, as such term is used in 11 U.S.C. §555, in respect of (i) any extension of credit for the clearance or settlement of securities transactions or (ii) any margin loan, as each such term is used in 11 U.S.C. §741(7), by a securities clearing bank. As used herein, “securities clearing bank” refers to any financial participant, as defined in 11 U.S.C. §101(22A), that extends credit for the clearance or settlement of securities transactions to one or more Primary Government Securities Dealers designated as such by the Federal Reserve Bank of New York from time to time; or

G. any setoff or liquidating transaction undertaken pursuant to the rules or bylaws of any securities clearing agency registered under section 17A(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78q-1(b), or by any person acting under instructions from and on behalf of such a securities clearing agency; or

H. any settlement transaction undertaken by such securities clearing agency using securities either (i) in its custody or control, or (ii) in the custody or control of another securities agency with which it has a Commission approved interface procedure for securities transactions settlements, provided that the entire proceeds thereof, without benefit of any offset, are promptly turned over to the trustee; or

I. any transfer or delivery to a securities clearing agency by a bank or other depository, pursuant to instructions given by such clearing agency, of cash, securities, or other property of the Defendant held by such bank or depository subject to the instructions of such clearing agency and constituting a margin payment as defined in 11 U.S.C. §741(5).

IX. ORDERED that pursuant to 15 U.S.C. §78eee(b)(4), this liquidation proceeding is removed to the United States Bankruptcy Court for the Southern District of New York.

X. ORDERED that the trustee is authorized to take immediate possession of the property of the Defendant, wherever located, including but not limited to the books and records of the Defendant, and to open accounts and obtain a safe deposit box at a bank or banks to be chosen by the trustee, and the trustee may designate such of his representatives who shall be authorized to have access to such property.

Date: December 15, 2008

4:08 PM

Louis L. Stanton  
UNITED STATES DISTRICT JUDGE



A-651

12-01778-11: Doc 20791 Filed 08/31/12 Entered 08/31/12 21:14 Page 1 of 1 Exhibit G  
Pg 8 of 29

 ORIGINAL

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

-----X  
SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

- against - :

BERNARD L. MADOFF and  
BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC, :

Defendants. :

-----X

USDC SDNY  
DOCUMENT  
ELECTRONICALLY FILED  
DOC #:  
DATE FILED: 12/18/08

08 Civ. 10791 (LLS)  
ECF CASE

**ORDER ON CONSENT IMPOSING PRELIMINARY INJUNCTION,  
FREEZING ASSETS AND GRANTING OTHER RELIEF AGAINST DEFENDANTS**

The Securities and Exchange Commission (“SEC”) having filed a Complaint in this matter on December 11, 2008; the SEC that same day having filed an Application for Emergency Preliminary Relief Against Defendants Bernard L. Madoff (“Madoff”) and Bernard L. Madoff Investment Securities LLC (“BMIS”) (collectively, “Defendants”); Defendants that same day having entered a general appearance and consented to the Court’s jurisdiction over the Defendants and the subject matter of this action; Defendants on December 12, 2008 having consented to the entry of a temporary restraining order, asset freeze, appointment of a receiver and other relief against Defendants; the Court that same day having entered such an Order; the Court on December 15, 2008 having issued an Order appointing Irving H. Picard, Esq. (“SIPC Trustee”), as trustee for the liquidation of the business of Defendants with all the duties and powers of a trustee described in the Securities Investor Protection Corporation (“SIPC”), and appointing the law firm of Baker & Hostetler LLP as appointed counsel for the trustee; and Defendants having consented to the entry of this Order On Consent Imposing Preliminary

Injunction, Freezing Assets And Granting Other Relief Against Defendants, waived findings of fact and conclusions of law, and waived any right to appeal from this P.I. Order:

**I.**

**IT IS HEREBY ORDERED**, pending a final disposition of this action, that Defendants, and each of their partners, agents, scrvants, employees, and attorneys, and those persons in active concert or participation with them who receive actual notice of this Order by personal service, facsimile service, telephonic notice, notice by e-mail or otherwise, are preliminarily enjoined from, directly or indirectly, singly or in concert, in the offer, purchase or sale of any security, by use of any means or instruments of transportation or communication in interstate commerce or by use of the mails:

- a. employing any device, scheme or artifice to defraud;
- b. obtaining money or proprty by means of an untrue statement of material fact or omitting to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading; and
- c. engaging in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser,

in violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

**II.**

**IT IS FURTHER ORDERED**, pending a final disposition of this action, that Defendants, and each of their partners, agents, servants, employees, and attorneys, and those persons in active concert or participation with them who receive actual notice of this Order by

personal service, facsimile service, telephonic notice, notice by e-mail or otherwise, are preliminarily enjoined from, directly or indirectly, singly or in concert, by use of any means or instruments of transportation or communication in interstate commerce or by use of the mails:

- a. employing any device, scheme or artifice to defraud any client or prospective client;
- b. engaging in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon any client or prospective client,

in violation of Sections 206(1) and 206(2) of the Advisers Act.

**III.**

**IT IS FURTHER ORDERED**, pending a final disposition of this action, that Defendants, and each of their financial and brokerage institutions, agents, servants, employees, attorneys, and those persons in active concert or participation with either of them who receive actual notice of this Order by personal service, facsimile service, telephonic notice, notice by e-mail, or otherwise, and each of them, hold and retain within their control, and otherwise prevent, any withdrawal, transfer, pledge, encumbrance, assignment, dissipation, concealment or other disposal of any assets, funds, or other property (including money, real or personal property, securities, commodities, choses in action or other property of any kind whatsoever) of, held by, or under the direct or indirect control of, Defendants, whether held in the name of Madoff, BMIS, Madoff International or Madoff Ltd. or for the direct or indirect beneficial interest of one or both of them, wherever situated, in whatever form such assets may presently exist and wherever located, and direct each of the financial or brokerage institutions, debtors and bailees, or any other person or entity holding such assets, funds or other property of Defendants,

LLS

to hold or retain within its control and prohibit the withdrawal, removal, transfer or other disposal of any such assets, funds or other properties, including, but not limited to: (1) all assets, funds, or other properties held in the name of, held by, or under the control of one or both of the Defendants; (2) all accounts in the name of Madoff or BMIS or on which Madoff is a signatory, including the accounts listed on the attached Exhibit A; (3) all artwork, property, motor vehicles, jewelry and other items of personalty held in the name of, held by, or under the control of Madoff or BMIS; and (4) all real property held in the name of, held by, or under the control of Madoff or BMIS.

**IV.**

**IT IS FURTHER ORDERED**, pending a final disposition of this action, that Defendants, and any person or entity acting at their direction or on their behalf, are preliminarily enjoined from destroying, altering, concealing or otherwise interfering with, the access of the Plaintiff Commission and/or SPIC Trustee to any and all documents, books and records, that are in the possession, custody or control of Defendants, and each of their partners, agents, employees, servants, accountants, financial or brokerage institutions, attorneys-in-fact, subsidiaries, affiliates, predecessors, successors and related entities that refer, reflect or relate to the allegations in the Complaint, including, without limitation, documents, books, and records referring, reflecting or relating to Defendants' finances or business operations, or the offer or sale of securities by Defendants and the use of proceeds therefrom.

**V.**

**IT IS FURTHER ORDERED** that Defendants and their partners, agents, employees, attorneys, or other professionals, anyone acting in concert with them or on their behalf, and any

third party, are preliminarily enjoined from filing a bankruptcy proceeding against Defendants without filing a motion on at least three (3) days' notice to the Plaintiff, and approval of this Court after a hearing.

**VI.**

**IT IS FURTHER ORDERED** that:

1. Defendant Madoff shall serve upon Plaintiff, on or before December 31, 2008, a verified written accounting, under penalty of perjury, of:
  - a. All assets, liabilities and property currently held, directly or indirectly, by or for the benefit of Defendant Madoff, including, without limitation, bank accounts, brokerage accounts, investments, business interests, loans, lines of credit, and real and personal property wherever situated, describing each asset and liability, its current location and amount;
  - b. All money, property, assets and income received by Defendant Madoff, or for the direct or indirect benefit of Defendant Madoff, at any time through the date of such accounting, describing the source, amount, disposition and current location of each of the items listed;
  - c. The names and last known addresses of all bailees, debtors, and other persons and entities that currently are holding the assets, funds or property of Defendant Madoff; and
  - d. The names and locations of all entities where Defendant BMIS, or entities controlled by, or related to, BMIS, held, without limitation, bank accounts, brokerage accounts, investments, or assets.

Defendant Madoff shall serve such verified written accountings by hand delivery, facsimile transmission, email or overnight courier service on the Commission's counsel, Alex Vasilescu, Esq., Securities and Exchange Commission, 3 World Financial Center, Room 400, New York, NY 10281, [vasilescua@sec.gov](mailto:vasilescua@sec.gov).

#### VII.

**IT IS FURTHER ORDERED** that Lee Richards, Esq., of Richards Kibbe & Orbe LLP, continues as the appointed receiver for the assets of Madoff Securities International Ltd. ("Madoff International"), Madoff Ltd., and any other broker-dealer, market making, or investment advisory businesses (the "Foreign Entities") not located in the United States of America that are owned or controlled, in whole or in part, by Madoff, BMIS and their partners, agents, employees, attorneys, or other professionals, anyone acting in concert with them or on their behalf, and any third party, to (i) preserve the status quo, (ii) ascertain the extent of commingling of funds between Madoff, BMIS and the Foreign Entities; (iii) ascertain the true financial condition of the Foreign Entities and the disposition of investor funds; (iv) prevent further dissipation of the property and assets of the Foreign Entities; (v) prevent the encumbrance or disposal of property or assets of the Foreign Entities and the investors; (vi) preserve the books, records and documents of the Foreign Entities; (vii) respond to investor inquiries regarding the foreign entities; (viii) protect the assets of the Foreign Entities from further dissipation; (ix) determine whether the Foreign Entities should undertake bankruptcy filings; and (x) determine the extent to which the freeze should be lifted as to certain assets in the custody of the Foreign Entities.

To effectuate the foregoing, the receiver is empowered to:

- (a) Take and retain immediate possession and control of all of the assets and property, and all books, records and documents of, the Foreign Entities;
- (b) Have exclusive control of, and be made the sole authorized signatory for, all accounts at any bank, brokerage firm or financial institution that has possession or control of any assets or funds of the Foreign Entities;
- (c) Conduct business, including making trades, and pay from available funds necessary business expenses, as required to preserve or maximize the value of the assets and property of the Foreign Entities, notwithstanding the asset freeze imposed by paragraph III, above;
- (d) Locate assets that may have been conveyed to third parties or otherwise concealed by the Foreign Entities;
- (e) Engage and employ persons, including accountants, attorneys and experts, to assist in the carrying out of the receiver's duties and responsibilities hereunder, including appointing a person or entity to manage any aspect of the business of the Foreign Entities, including any investment adviser business and market-making businesses of the Foreign Entities, and to use available funds as required to preserve the assets and property of the Foreign Entities, notwithstanding the asset freeze imposed by paragraph III, above;
- (f) Report to the Court and the parties by January 26, 2009, subject to such reasonable extensions as the Court may grant, the following information:
  - 1. All assets, money, funds, securities, and real or personal property then held directly or indirectly by or for the benefit of the Foreign Entities,

- including, but not limited to, real property, bank accounts, brokerage accounts, investments, business interests, personal property, wherever situated, identifying and describing each asset, its current location and value;
2. A list of secured creditors and other financial institutions with an interest in the receivership assets of the Foreign Entities;
  3. A list of customers and clients of the Foreign Entities, including investment advisory clients, and, to the extent practicable, the amounts received by Madoff from each such customer or client and the amounts withdrawn by each such customer or client;
- (g) Develop a preliminary plan for the administration of the assets of the receivership of the Foreign Entities, including a recommendation regarding whether bankruptcy cases should be filed for all or a portion of the assets subject to the receivership and a recommendation whether litigation against third parties should be commenced on a contingent fee basis to recover assets of the Foreign Entities for the benefit of the receivership.

Defendants agree to provide any written authorizations necessary for the receiver to exercise the foregoing powers over the Foreign Entities.

As this Court has entered an Order (referenced above) appointing the SIPC Trustee, and as the SIPC Trustee has roles and responsibilities with respect to BMIS, the receiver will have no authority over BMIS, except to the extent that such authority is necessary to carry out his responsibilities with respect to the Foreign Entities and that such authority is exercised with the

prior consent and approval of the SIPC Trustee.

**VIII.**

**IT IS FURTHER ORDERED** that each of the Receiver and his advisors be, and they hereby are, indemnified by each of the Defendants, Madoff International and Madoff Ltd., except for gross negligence, willful misconduct, fraud, and breach of fiduciary duty determined by final order no longer subject to appeal or certiorari, for all judgments, losses, costs, and reasonable expenses including legal fees (which shall be paid under the indemnity after court approval as they arise), arising from or related to any and all claims of whatsoever type brought against any of them in their capacities as receiver or advisors to the receiver; provided, however, that nothing herein shall limit the immunity of the receiver and his advisors allowed by law or deprive the receiver and his advisors of indemnity for any act or omission for which they have immunity.

**IX.**

**IT IS FURTHER ORDERED** that no creditor or claimant against the Defendants, or any person acting on behalf of such creditor or claimant, shall take any action to interfere with the control, possession, or management of the assets subject to the receivership.

**A-660**

12-01778-1 Doc-20-791 Filed 08/31/12 Entered 08/31/12 14:10 Exhibit G  
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**X.**

**IT IS FURTHER ORDERED** that, pending final disposition of this action or such further order of the Court, Plaintiff may conduct expedited discovery, pursuant to Rules 26, 30, 31, 33, 34, 36 and 45 of the Federal Rules of Civil Procedure and without the requirement of a meeting pursuant to Fed. R. Civ. P. 26(f).

**XI.**

**IT IS FURTHER ORDERED** that this Order shall be, and is, binding upon Defendants and their partners, agents, servants, employees, attorneys, subsidiaries, affiliates and those persons in active concert or participation with them who receive actual notice of this Order by personal service, facsimile service, telephone, e-mail or otherwise.

**XII.**

**IT IS FURTHER ORDERED** that the Consent of Defendants to Preliminary Injunction Order filed herewith is incorporated herein with the same force and effect as if fully set forth herein, and that Defendants shall comply with all of the undertakings and agreements set forth therein.

Louis L. Stanton  
UNITED STATES DISTRICT JUDGE

Issued at : 6 : 35 p.m.  
December 18, 2008  
New York, NY

12/18/2008 THU 19:56 FAX 2123361317

US SECURITIES & COMM

002

12-01785-00 Doc 20-791 Filed 08/31/12 Entered 08/31/12 14:11 Exhibit G

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**Exhibit A**

JP Morgan Chase Account No. 000000140081703  
Account in the Name of: Bernard L. Madoff Investment Securities

JP Morgan Chase Account No. 000000066709466  
Account in the Name of: Bernard L. Madoff Investment Securities

The Bank of New York Mellon Account No. 890-0402-393  
Account in the Name of: Benard L Madoff Investment Securities

The Bank of New York Mellon Account No. 030-0951050  
Account in the Name of: Bernard L Madoff

The Bank of New York Mellon Account No. 866-1126-621  
Account in the Name of: Bernard L Madoff Investment Securities LLC

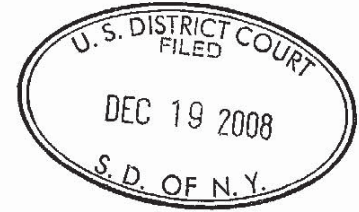
**A-662**

12-01778-brl Doc 20-7 Filed 08/31/12 Entered 08/31/12 21:14:11 Exhibit G

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**ORIGINAL**

**JAMES CLARKSON**  
**ACTING REGIONAL DIRECTOR**  
**Attorney for Plaintiff**  
**SECURITIES AND EXCHANGE COMMISSION**  
**New York Regional Office**  
**3 World Financial Center – RM 400**  
**New York, NY 10281**  
**(212) 336-1020**



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

-----X  
**SECURITIES AND EXCHANGE COMMISSION,** :

**Plaintiff,** :

**- against -** :

**BERNARD L. MADOFF and** :  
**BERNARD L. MADOFF INVESTMENT** :  
**SECURITIES LLC,** :

**Defendants.** :

**08 Civ. 10791 (LLS)**  
**ECF CASE**

-----X

**CONSENT OF DEFENDANT BERNARLD L. MADDOFF TO**  
**PRELIMINARY INJUNCTION ORDER**

1. Defendant Bernard L. Madoff (“Madoff”), on his individual behalf, and to the extent, if any, he owns or controls Defendant Bernard L. Madoff Investment Securities LLC (“BMIS;” collectively, “Defendants”) and Madoff Securities International Ltd. (“Madoff International”), Madoff Ltd., and any other broker-dealer, market making, or investment advisory businesses (the “Foreign Entities”) acknowledge having been served with the summons and complaint in this action, enter a general appearance, and admit the Court’s jurisdiction over Defendants and over the subject matter of this action.

2. Defendants hereby consent to the entry of the proposed Order Imposing a Preliminary Injunction, Freezing Assets and Granting Other Relief Against Defendants in the form attached hereto (the "P.I. Order") and incorporated by reference herein.

3. Defendants waive the entry of findings of fact and conclusions of law pursuant to Rule 65 of the Federal Rules of Civil Procedure.

4. Defendants waive the right, if any, to appeal from the entry of the proposed P.I. Order.

5. Defendants enter into this Consent voluntarily and represent that no threats, offers, promises, or inducements of any kind have been made by the Commission or any member, officer, employee, agent, or representative of the Commission to induce Defendants to enter into this Consent.

6. Defendants agree that this Consent shall be incorporated into the P.I. Order with the same force and effect as if fully set forth therein.

7. Defendants will not oppose the enforcement of the P.I. Order on the ground, if any exists, that it fails to comply with Rule 65(d) of the Federal Rules of Civil Procedure, and hereby waive any objection based thereon.


8. Defendants waive service of the P.I. Order and agree that entry of the P.I. Order by the Court and filing with the Clerk of the Court will constitute notice to Defendants of its terms and conditions.

9. Defendants acknowledge that no promise or representation has been made by the Commission or any member, officer, employee, agent, or representative of the Commission with regard to any criminal liability that may have arisen or may arise from the facts underlying this action or immunity from any such criminal liability. Defendants further acknowledge that the

Court's entry of a PI Order may have collateral consequences under federal or state law and the rules and regulations of self-regulatory organizations, licensing boards, and other regulatory organizations. Such collateral consequences include, but are not limited to, a statutory disqualification with respect to membership or participation in, or association with a member of, a self-regulatory organization. This statutory disqualification has consequences that are separate from any sanction imposed in an administrative proceeding.

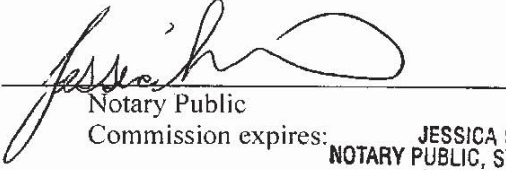
10. Defendants agree that the Commission may present the proposed P.I. Order to the Court for signature and entry without further notice.

Dated: 12/18/08



By: Bernard L. Madoff  
In his individual capacity and in his capacity, if any,  
as the owner or controlling person of Bernard L.  
Madoff Investment Securities LLC, Madoff  
Securities International Ltd. and Madoff Ltd.

On Dec 18, 2008, Bernard L. Madoff, a person known to me,  
personally appeared before me and acknowledged executing the foregoing Consent.

  
Notary Public  
Commission expires:

JESSICA SHANNON  
NOTARY PUBLIC, STATE OF NEW YORK  
NO. 01SH6136253  
QUALIFIED IN BRONX COUNTY  
COMMISSION EXPIRES 11/07/2009

Approved as to form:

Ira Lee Sorokin  
Ira Lee Sorokin  
1177 Avenue of the Americas  
New York, NY

**A-665**

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10036-2714

T: (212) 277-6576

*Attorney for Defendants Bernard L. Madoff  
and Bernard L. Madoff Investment Securities LLC*

**A-666**

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Case 1:08-cv-10791-LLS Document 8-3 Filed 12/18/08 Page 1 of 2

**ORIGINAL**



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

-----X	
<b>SECURITIES AND EXCHANGE COMMISSION,</b>	:
	:
<b>Plaintiff,</b>	:
	:
<b>- against -</b>	:
	:
<b>BERNARD L. MADOFF and</b>	:
<b>BERNARD L. MADOFF INVESTMENT</b>	:
<b>SECURITIES LLC,</b>	:
	:
<b>Defendants.</b>	:
	:
-----X	

**08 Civ. 10791 (LLS)  
ECF CASE**

**CONSENT OF SIPC TRUSTEE TO PRELIMINARY INJUNCTION  
ORDER**

1. David Sheehan, Esquire, on behalf of Irving Picard ("SIPC Trustee"), who is the appointed trustee Bernard L. Madoff Investment Securities LLC ("Defendant BMIS") and who has all the duties and powers of a trustee as prescribed in the Securities Investor Protection Act of 1970, hereby consents to the entry of the proposed Order Imposing a Preliminary Injunction, Freezing Assets and Granting Other Relief Against Defendants in the form attached hereto (the "P.I. Order") and incorporated by reference herein.

2. Defendant BMIS agrees that this Consent shall be incorporated into the P.I. Order with the same force and effect as if fully set forth therein.

3. Defendant BMIS waives service of the P.I. Order and agrees that entry of the P.I. Order by the Court and filing with the Clerk of the Court will constitute notice to Defendants of its terms and conditions.

**A-667**

12-01778-brl Doc 20-7 Filed 08/31/12 Entered 08/31/12 21:14:11 Exhibit G

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Case 1:08-cv-10791-LLS Document 8-3 Filed 12/18/08 Page 2 of 2

4. Defendant BMIS agrees that the Commission may present the proposed P.I. Order to the Court for signature and entry without further notice.

Dated: 12/18/08



David Sheehan, Esq.  
Baker Hostetler  
45 Rockefeller Plaza  
New York, New York 10111  
(212) 589-4616

Attorney for Irving H. Picard, SIPC Trustee  
For Defendant Bernard L. Madoff  
Investment Securities LLC

A-668

12-01778-11: Dec 20 2009 Filed 08/31/12 Entered 08/31/12 21:14 Page 1 Exhibit G  
Pg 25 of 29

**ORIGINAL**

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

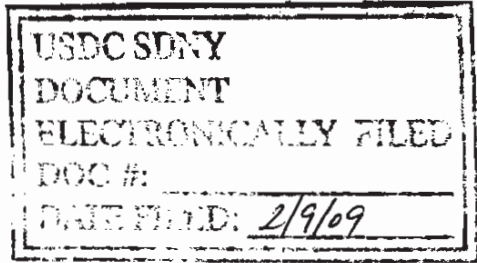
-----x  
SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

- against -

BERNARD L. MADOFF and  
BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendants.  
-----x



08 Civ. 10791 (LLS)  
ECF CASE

**PARTIAL JUDGMENT ON CONSENT IMPOSING  
PERMANENT INJUNCTION AND CONTINUING OTHER RELIEF**

The Securities and Exchange Commission ("SEC") having filed a Complaint in this matter on December 11, 2008; the SEC that same day having filed an Application for Emergency Preliminary Relief Against Defendants Bernard L. Madoff ("Madoff") and Bernard L. Madoff Investment Securities LLC ("BMIS") (collectively, "Defendants"); Defendants that same day having entered a general appearance and consented to the Court's jurisdiction over the Defendants and the subject matter of this action; Defendants on December 12, 2008 having consented to the entry of a temporary restraining order, asset freeze, appointment of a receiver and other relief against Defendants; the Court that same day having entered such an Order; the Court on December 15, 2008 having issued an Order appointing Irving H. Picard, Esq. ("SIPC Trustee"), as trustee for the liquidation of the business of Defendants with all the duties and powers of a trustee described in the Securities Investor Protection Corporation ("SIPC"), and appointing the law firm of Baker & Hostetler LLP as appointed counsel for the trustee; and the Court having entered on December 18, 2008, the Order On Consent Imposing Preliminary

Injunction, Freezing Assets And Granting Other Relief Against Defendants (the "P.I. Order"); and Defendant Madoff having consented to entry of this Partial Judgment without admitting or denying the allegations of the Complaint (except as to jurisdiction), waived findings of fact and conclusions of law, and waived any right to appeal from this Partial Judgment:

**I.**

**IT IS HEREBY ORDERED, ADJUDGED, AND DECREED** that Defendant Madoff, and each of his partners, agents, servants, employees, and attorneys, and those persons in active concert or participation with them who receive actual notice of this Order by personal service, facsimile service, telephonic notice, notice by e-mail or otherwise, are permanently enjoined from, directly or indirectly, singly or in concert, in the offer, purchase or sale of any security, by use of any means or instruments of transportation or communication in interstate commerce or by use of the mails:

- a. employing any device, scheme or artifice to defraud;
- b. obtaining money or property by means of an untrue statement of material fact or omitting to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading; and
- c. engaging in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser, in violation of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)], Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder, [17 C.F.R. § 240.10b-5].

**II.**

**IT IS HEREBY FURTHER ORDERED, ADJUDGED AND DECREED** that Defendant Madoff, and each of his partners, agents, servants, employees, and attorneys, and those persons in active concert or participation with them who receive actual notice of this Order by personal service, facsimile service, telephonic notice, notice by e-mail or otherwise, are permanently enjoined from, directly or indirectly, singly or in concert, by use of any means or instruments of transportation or communication in interstate commerce or by use of the mails:

- a. employing any device, scheme or artifice to defraud any client or prospective client; or
- b. engaging in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon any client or prospective client, in violation of Sections 206(1) and 206(2) of the Advisers Act of 1940 (“Advisers Act”) [15 U.S.C. §§ 80b-6(1), (2)].

**III.**

**IT IS HEREBY FURTHER ORDERED, ADJUDGED AND DECREED** that Defendant Madoff shall pay disgorgement of ill-gotten gains, prejudgment interest thereon, and a civil penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)], Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] and Section 209(e) of the Advisers Act [15 U.S.C. § 80b-9]. The Court shall determine the amounts of the disgorgement and civil penalty upon motion of the SEC. Prejudgment interest shall be calculated from the date of the first violation, based on the rate of interest used by the Internal Revenue Service for the underpayment of federal income tax as set forth in 26 U.S.C. § 6621(a)(2). In connection with

the SEC's motion for disgorgement and/or civil penalties, and at any hearing held on such a motion: (a) Defendant Madoff will be precluded from arguing that he did not violate the federal securities laws as alleged in the Complaint; (b) Defendant Madoff may not challenge the validity of the Consent or this Partial Judgment; (c) solely for the purposes of such motion, the allegations of the Complaint shall be accepted as and deemed true by the Court; and (d) the Court may determine the issues raised in the motion on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence, without regard to the standards for summary judgment contained in Rule 56(c) of the Federal Rules of Civil Procedure. In connection with the SEC's motion for disgorgement and/or civil penalties, the parties may take discovery, including discovery from appropriate non-parties.

#### IV.

**IT IS HEREBY FURTHER ORDERED** that Sections III through XII of the Court's Order On Consent Imposing Preliminary Injunction, Freezing Assets And Granting Other Relief Against Defendants, entered on December 18, 2008, are incorporated into this Partial Judgment and shall remain in full force until this action is fully resolved or as otherwise ordered by this Court.

#### V.

**IT IS FURTHER ORDERED** that this Partial Judgment shall be, and is, binding upon Defendant Madoff and his partners, agents, servants, employees, attorneys, subsidiaries, affiliates and those persons in active concert or participation with them who receive actual notice of this Order by personal service, facsimile service, telephone, e-mail or otherwise.

**A-672**

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Exhibit G  
Pg 29 of 29

VI.

**IT IS FURTHER ORDERED** that the Consent of Defendant Bernard L. Madoff to a Partial Judgment filed herewith is incorporated herein with the same force and effect as if fully set forth herein, and that Defendant Madoff shall comply with all of the undertakings and agreements set forth therein.

Louis L. Stanton  
UNITED STATES DISTRICT JUDGE

Issued at : 12 : 19 p.m.  
February 9, 2009  
New York, NY

*ms*

**A-673**

12-01778-brl Doc 20-8 Filed 08/31/12 Entered 08/31/12 21:14:11 Exhibit H  
Pg 1 of 3

# **EXHIBIT H**

# Bloomberg

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## Madoff Trustee Drops \$279 Million From Claim Against Merkin

By Erik Larson - Nov 07, 2009

Nov. 7 (Bloomberg) -- The liquidator for [Bernard Madoff's](#) firm reduced by \$279 million the amount of fake profit he wants returned from [J. Ezra Merkin's](#) Ariel and Gabriel funds, which invested one-fourth of their money with the con man.

Trustee [Irving Picard](#), who is suing Madoff's biggest investors to help repay victims, on Nov. 2 dropped one of 12 claims against the hedge fund manager in U.S. Bankruptcy Court in New York, citing "further review of the law."

In the abandoned claim, he had sought the return of "intra-fund" transfers of Madoff-linked money to Ariel and Gabriel from Merkin's third fund, Ascot, which is also named in the lawsuit and invested all of its money with Madoff.

"We've determined that the facts don't support a finding for the original fund being a conduit for the money," Picard said yesterday in a phone interview. "The ultimate amount we are seeking in the lawsuit doesn't change."

The receiver still seeks a total of \$564.6 million from the three funds, as well as from Merkin and his management company, Gabriel Capital Corp. With the claim dropped, Picard will have to try to get more money damages from Ascot, which lost almost all of its \$1.7 billion in the fraud.

Ascot withdrew \$527.6 million in fake profit from Madoff's firm from 1995 to 2008, according to Picard's complaint. Ariel and Gabriel, which managed a total of \$2.6 billion, withdrew \$40 million in fake profit from 2000 to 2008, Picard says.

### Remaining Claims

Cayman Islands-based Ariel and New York-based Gabriel, among the biggest Madoff investors, are being liquidated by court-appointed receiver [Bart M. Schwartz](#), who believes Picard's remaining claims are meritless.

“We continue to press forward with our motion to dismiss those claims,” Schwartz said in a letter yesterday to the New York State Court, where the funds are being liquidated.

Ascot is being liquidated separately by the court-appointed receiver [David Pitofsky](#) of the firm Goodwin Procter LLP. In July, Picard won a freeze on Ascot’s remaining assets of about \$10 million.

Lawyers for Ariel and Gabriel claim the funds’ managers didn’t know about Madoff’s fraud and withdrew only about 10 percent of their holdings in Bernard L. Madoff Investment Securities LLC.

Merkin, of New York, was closely associated with Madoff on a business and social level since at least the 1990s, according to the complaint. The men sat together on the board of trustees for Yeshiva University, Picard said.

New York Attorney General [Andrew Cuomo](#) sued Merkin and Gabriel Capital Corp. in April over claims he secretly placed client money with Madoff in exchange for \$470 million in fees. Merkin has denied the claims and wants the lawsuit dismissed.

Madoff pleaded guilty in March to using his investment company as a Ponzi scheme. He is serving a 150-year sentence.

The case is Picard v. Merkin, 09-ap-01182, U.S. Bankruptcy Court, Southern District of New York (Manhattan).

To contact the reporter on this story: [Erik Larson](#) in New York at [elanson4@bloomberg.net](mailto:elanson4@bloomberg.net).

To contact the editor responsible for this story: David E. Rovella at [drovella@bloomberg.net](mailto:drovella@bloomberg.net).

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**UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**

SECURITIES INVESTOR PROTECTION  
CORPORATION,

Plaintiff,

- against -

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

In re:

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Debtor.

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

Plaintiff,

- against -

ERIC T. SCHNEIDERMAN, as successor to  
ANDREW M. CUOMO, Attorney General of the  
State of New York; BART M. SCHWARTZ, as  
Receiver for ARIEL FUND, LTD. and GABRIEL  
CAPITAL, L.P.; DAVID PITOFISKY, as Receiver  
for ASCOT PARTNERS, L.P., ASCOT FUND,  
LTD.; J. EZRA MERKIN; and GABRIEL  
CAPITAL CORPORATION,

Defendants.

Adv. Pro. No. 12-01778

**JOINT MEMORANDUM OF LAW IN SUPPORT OF  
MOTION TO WITHDRAW THE REFERENCE**

**ERIC T. SCHNEIDERMAN**  
**ATTORNEY GENERAL OF THE STATE OF**  
**NEW YORK**

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*Attorneys for the People of the  
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Facsimile: (212) 521-5450

*Attorneys for Bart M. Schwartz as Receiver for  
Ariel Fund, Ltd. and Gabriel Capital, L.P.*

*(Counsel Continued Inside)*

**A-677**

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Pg 2 of 33

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*Attorneys for David Pitofsky as Receiver for  
Ascot Partners, L.P. and Ascot Fund, Ltd.*

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in the NYAG Action and the Ariel & Gabriel Receiver's action. It also provides for a release of claims by the Ascot Receiver, and releases by all investors in the Funds who elect to participate.

Most of the proceeds from the Merkin Settlement will be paid to victims of the Merkin Defendants, who are not BLMIS customers. The remainder will be utilized to defend against, or settle, claims brought by the Trustee against the Receivers and the Merkin Defendants, or to pay the costs of the Receivers and the NYAG.

### **RELIEF REQUESTED**

The NYAG and Receivers request that this Court withdraw the reference of this Stay Action to resolve issues that they respectfully submit must be resolved by an Article III Court. Even if withdrawal were not mandatory, however, there are clear and compelling reasons why this Court should exercise its broad discretion to withdraw the reference.

#### **I.**

#### **WITHDRAWAL OF THE REFERENCE IS MANDATORY**

##### **A. THE STATUTORY BASIS FOR WITHDRAWAL OF THE REFERENCE**

The Securities Investor Protection Act (15 U.S.C. SIPA §§78aaa-78lll) ("SIPA") provides that the District Court shall have the same jurisdiction over a SIPA proceeding as it would have over a case arising under the Bankruptcy Code. *See* 15 U.S.C. § 78eee(b)(2)(A). The Bankruptcy Court is a tribunal with limited jurisdiction that cannot exercise judicial power. *See Stern*, 131 S. Ct. at 2620. It is for this reason that original and exclusive jurisdiction over bankruptcy and SIPA cases is vested in the District Court. *See* 28 U.S.C. § 1334(a).

Under 28 U.S.C. § 1334, the District Court has jurisdiction over all civil proceedings "arising under" the Bankruptcy Code, or "arising in" or "related to" cases under the Bankruptcy Code. Under 28 U.S.C. § 157(a), the District Court may refer to the Bankruptcy Court within the same district "all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11." A standing order of the District Court automatically refers

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**UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**

SECURITIES INVESTOR PROTECTION  
CORPORATION,

Plaintiff,

- against -

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

In re:

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Debtor.

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

Plaintiff,

- against -

ERIC T. SCHNEIDERMAN, as successor to  
ANDREW M. CUOMO, Attorney General of the  
State of New York; BART M. SCHWARTZ, as  
Receiver for ARIEL FUND LTD. and GABRIEL  
CAPITAL, L.P.; DAVID PITOFISKY, as Receiver  
for ASCOT PARTNERS L.P., ASCOT FUND,  
LTD.; J. EZRA MERKIN; and GABRIEL  
CAPITAL CORPORATION,

Defendants.

Adv. Pro. No. 12-01778

**NOTICE OF JOINDER IN  
MOTION TO WITHDRAW THE REFERENCE**

**PLEASE TAKE NOTICE** that Defendants J. Ezra Merkin and Gabriel Capital Corporation (collectively, the “Merkin Defendants”) hereby join in the motion to withdraw the reference to the Bankruptcy Court filed by Defendants Eric T. Schneiderman, as successor to Andrew M. Cuomo, Attorney General of the State of New York (the “NYAG”), Bart M. Schwartz, as Receiver for Ariel Fund Ltd. and Gabriel Capital, L.P., David Pitofsky, as Receiver for Ascot Partners L.P., (collectively, the “Receivers”). The legal arguments as to why withdrawal of the reference is mandatory or, in the alternative, why permissive withdrawal is appropriate, are fully addressed in

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the joint memorandum of law of the NYAG and the Receivers. Rather than burden the Court with duplicative briefing, the Merkin Defendants join in those legal arguments (but not any factual characterizations in the brief).

Dated: New York, New York  
August 31, 2012

**DECHERT LLP**

By: 

Andrew J. Levander

Neil A. Steiner

1095 Avenue of the Americas

New York, New York 10036

Telephone: (212) 698-3500

*Attorneys for Ezra J. Merkin and Gabriel  
Capital Corporation*

**UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**

SECURITIES INVESTOR PROTECTION  
CORPORATION,

Plaintiff,

- against -

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

In re:

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Debtor.

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

Plaintiff,

- against -

ERIC T. SCHNEIDERMAN, as successor to  
ANDREW M. CUOMO, Attorney General of  
the State of New York; BART M.  
SCHWARTZ, as Receiver for ARIEL FUND  
LTD. and GABRIEL CAPITAL, L.P.; DAVID  
PITOFISKY, as Receiver for ASCOT  
PARTNERS L.P., ASCOT FUND, LTD.; J.  
EZRA MERKIN; and GABRIEL CAPITAL  
CORPORATION,

Defendants.

Adv. Pro. No. 12-01778

**DECLARATION OF DAVID N. ELLENHORN IN SUPPORT  
OF DEFENDANTS' JOINT MOTION TO WITHDRAW THE REFERENCE**

DAVID N. ELLENHORN, an attorney duly admitted to practice in the State of New York, and a member of the bar of this Court, hereby declares the following to be true and correct, under penalty of perjury:

1. I am a Senior Trial Counsel in the Office of the Attorney General of the State of New York. I have been in charge of the AG's action against J. Ezra Merkin, and his solely-owned management company, Gabriel Capital Corp. ("Merkin"), since inception. I submit this declaration to provide a context to the pending motion to withdraw the reference.

**The AG's Action**

2. Merkin was the general partner of Ascot Partners, L.P. and Gabriel Capital, L.P. and an investment advisor to Ascot Fund Limited and Ariel Fund Limited (collectively, the "Funds"). The assets of the two Ascot Funds were wholly invested with and controlled by Bernard Madoff, almost from their inception in 1992, and between 25% and 30% of the Ariel and Gabriel assets generally were invested with Madoff.

3. In 2009, following a four-month investigation in which the AG reviewed thousands of documents, deposed Merkin and others, and interviewed hundreds of Merkin investors, the AG filed a complaint against Merkin in New York Supreme Court alleging violations of the Martin Act, Executive Law §63(12), the Not-for-Profit Corporation Law, and common-law causes of action. The case was assigned to Justice Richard B. Lowe, III. On May 28, 2009 the AG filed an amended complaint which added the Funds as Relief Defendants.

4. The Complaint alleged, in substance, that Merkin had systematically misled investors by assuring them that he, and he alone, was actively managing their investments, when, in fact, he had delegated all investment responsibility to Madoff for the Ascot Funds, and all Ariel and Gabriel assets to Madoff and other undisclosed managers. For example, an Ascot Offering

Memoranda stated that “All decisions with respect to the management of the capital of the Partnership are made exclusively by J. Ezra Merkin.” In fact, the Ascot Funds actually were managed by Madoff. In addition, Madoff’s role was concealed by Merkin in various oral conversations with investors and potential investors. The Complaint also alleged that Merkin breached his fiduciary duties by failing to conduct appropriate due diligence and supervision of Madoff’s activities.

5. Within days of filing the Complaint, the AG obtained a freeze order against Merkin’s assets to prevent their dissipation, and in May and June 2009, the AG obtained receivership orders removing the Funds from Merkin’s control and placing them under the authority of the New York Supreme Court. Bart Schwartz of Guidepost Partners was appointed receiver of the Ariel and Gabriel funds, and David Pitofsky of Goodwin Procter appointed receiver of Ascot Partners, L.P. Subsequently, the AG and the Receivers conducted an extensive analysis of Merkin’s assets, including his bank accounts, investment holdings, and corporate and personal records.

6. On July 1, 2009, Merkin filed a motion to dismiss the Complaint. The AG responded on August 3, 2009. In a February 8, 2010 decision, Justice Lowe denied Merkin’s motion to dismiss in its entirety. The Court found that the AG had pled sufficient facts showing that Merkin had misled investors in violation of the Martin Act and Executive Law §63(12), and failed to conduct appropriate due diligence, in breach of his fiduciary duties. A copy of the decision is annexed hereto as Exhibit A.

7. From April 2009 through September 2010, the parties took additional discovery, and, on October 18, 2010, the AG filed a motion for partial summary judgment seeking recovery of fees

Merkin had received from the Funds and other relief. After extensive briefing, the motion was argued in February 2011.

**Settlement Discussions Between Merkin, the AG and the Receivers**

8. Beginning in early 2010, Merkin and the AG engaged in extensive settlement negotiations. The Receivers also participated. After over a year of negotiations they reached a settlement and a settlement agreement was executed in December 2011. Under this agreement, Merkin was to pay \$415 million to the AG for distribution to the Funds' investors by the Receivers. The Agreement was conditioned, however, on Merkin and the Funds receiving a release from claims made against them by the SIPC Trustee, Irving Picard. In order to facilitate the Trustee's provision of releases, the Trustee was given a copy of the settlement agreement, and in December 2011 one of my colleagues and I met with David Sheehan and Tom Long of Baker Hostetler to explain to them the mechanics and terms of the agreement.

**Settlement Discussions Between the Receivers, Merkin and the Trustee**

9. Over the next four months, the Receivers and counsel for Merkin sought to negotiate a settlement of the Trustee's claims against Merkin and the Funds. These efforts included numerous meetings between the Receivers and the Trustee's counsel, in which there was full disclosure of Merkin's assets, liabilities, and financial condition. While these negotiations were taking place, the parties asked Justice Lowe to withhold his decision on the AG's summary judgment motion, and the Court did so. However, the Trustee rejected or failed to respond to various offers made by the Receivers and Merkin, and, I am informed, declined to make any counter-offer. At the end of April 2012, the Trustee's attorneys stated that the Trustee was not interested in further negotiations.

### **The Merkin Settlement Agreement**

10. As a result, the settlement agreement with Merkin was renegotiated so that the Trustee's release of Merkin and the Funds would no longer be required. On June 13, 2012, a new agreement was executed by the AG, Merkin, and the Receivers.

11. The final Settlement Agreement provides that Merkin will return \$410 million in fees he received from the Funds to settle the AG's claims. The bulk of these moneys will be distributed to eligible investors to compensate them for cash losses they suffered. Pursuant to the Agreement, all eligible investors will receive 42.5% of the first \$5 million of their cash losses. Large investors (defined as investors with more than \$5 million in cash losses) may submit to a simple process which will determine whether they knew that Merkin had delegated investment responsibility to Madoff. Those large investors who were not aware of this delegation may participate in a 'large investor settlement pool' which could provide up to 42.5% of their net losses *above* \$5 million. (Large investors who do not wish to participate in this claims process or had knowledge of Madoff's role and do not seek to qualify, will instead receive an additional 2.5% of their net losses above \$5 million.) Contrary to the Trustee's Complaint, this process is neither "complex" nor "costly" and is expected to involve very few investors. The claims process will be overseen by an independent settlement fund administrator and is expected to be conducted at minimal cost.

12. The settlement funds will be distributed to investors in two stages. The first distribution will occur approximately six months after the closing, and will be funded by approximately \$200 million that was realized from the sale of an art collection Merkin owned jointly with his wife, which was escrowed by an order of the New York court. The second stage will take place on a rolling basis over the next three years, and will be funded through the ongoing liquidation of

Merkin's interests in the Ariel and Gabriel portfolios, under the direction of their Receiver. No moneys will be distributed until months after the closing of the Settlement Agreement, which the AG has voluntarily agreed to postpone until the Trustee's motion for a preliminary injunction is heard.

#### **The Trustee and the AG**

13. On May 6, 2009, the Trustee sued Merkin and the Funds to recover allegedly fraudulent transfers made to the Funds by Madoff. An amended complaint was filed on December 23, 2009 to add a count to recover moneys transferred from the Funds to Merkin.

14. In November 2009, the Trustee informed the AG that he would seek to enjoin the AG's action against Merkin unless the AG agreed to turn over any funds he might obtain from Merkin to the Trustee. The AG declined to provide such assurances and provided the Trustee with reasons why the Trustee could not enjoin his enforcement action against Merkin. In addition, the AG invited the Trustee to enter into negotiations to settle their differences. After some preliminary discussions, the Trustee failed to respond to the AG's invitation to continue negotiations.

15. In mid-2011, I received a telephone call from Marc Powers, one of the Trustee's attorneys. He told me that he had heard that the AG was close to a settlement with Merkin, and if the AG did not agree within forty-eight hours that the Bankruptcy Court would have exclusive jurisdiction over any disputes between the Trustee and the AG, the Trustee would sue the AG to enjoin implementation of any settlement with Merkin. I told Mr. Powers that the AG would not agree to this demand but would be willing to discuss the matter with the Trustee. He responded that he would call me in a day or two to set up a meeting, but I never heard from him again.

16. In June 2012, after the AG publicly announced the settlement with Merkin, I received a request from one of Picard's counsel for a copy of the Settlement Agreement. We considered providing the Trustee with a copy, but ultimately decided not to do so because we believed it would prejudice the Funds in their defense of Trustee's lawsuit against them. I did however assure counsel that no funds would be distributed pursuant to the settlement agreement for many months. In addition, the principal terms, including those relating to the distribution of proceeds to investors, remained unchanged in the final Merkin Settlement from the December version provided to the Trustee.

17. On August 1, 2012, without notice, the Trustee sued the AG for a declaration that the AG's suit against Merkin is void *ab initio*. The Complaint seeks an injunction preventing the AG from completing the settlement or distributing any of Merkin's assets pursuant to the settlement.

18. In his Complaint, the Trustee alleges that the AG seeks to "abrogate" the "fundamental tenet" of SIPA and the Bankruptcy Code that "every victim should be treated equally" because, the Trustee claims, Merkin's assets should be distributed to all Madoff investors. In fact, that would have the effect of providing direct Madoff investors with a higher percentage recovery than Merkin investors would receive. The Merkin settlement funds are to be distributed to parties who did not invest with Madoff and were not customers of BLMIS but, rather, with Merkin, and they are in an entirely different category from Madoff's direct investors. Among other things, SIPC provides up to \$500,000 to each direct Madoff investor starting from the first dollar of losses. Soon after the Madoff fraud was disclosed, the Trustee announced that indirect Madoff investors, such as investors in Ascot, Ariel, and Gabriel, are ineligible for any SIPC payments.

19. Hundreds of Merkin investors had cash losses of \$500,000 or less. Had they been direct Madoff investors and received SIPC payments they would have recovered the bulk of their losses. Instead, they will receive distributions from the AG's settlement and whatever money, if any, the Trustee ultimately distributes to the Funds, following resolution of his claims against the Funds, and theirs against him.

20. As shown in the AG and Receivers joint memorandum of law, the Trustee has no right to enjoin or interfere with the Merkin settlement. The Trustee himself admits that his claim is "unusual, if not extraordinary" and it is unsupported by legal precedent. It is also inequitable.

Dated: New York, NY  
August 31, 2012

/s/ David N. Ellenhorn

David N. Ellenhorn

EXHIBIT A

to

**DECLARATION OF DAVID N. ELLENHORN IN SUPPORT  
OF DEFENDANTS' JOINT MOTION TO WITHDRAW THE REFERENCE**

26 Misc.3d 1237(A), 907 N.Y.S.2d 439, 2010 WL 936208 (N.Y.Sup.), Blue Sky L. Rep. P 74,821, 2010 N.Y. Slip Op. 50430(U)

(Table, Text in WESTLAW), Unreported Disposition  
(Cite as: 26 Misc.3d 1237(A), 2010 WL 936208 (N.Y.Sup.))

**C**

NOTE: THIS OPINION WILL NOT APPEAR IN A PRINTED VOLUME. THE DISPOSITION WILL APPEAR IN A REPORTER TABLE.

Supreme Court, New York County, New York.  
The PEOPLE of the State of New York By Andrew M. CUOMO, Attorney General of the State of New York, Plaintiff,

v.

J. Ezra MERKIN and Gabriel Capital Corporation, Defendants.

No. 450879/09.

Feb. 8, 2010.

Sangeap, Daniel, Rosen, Harriet B., Kadosh, Shmuel, for Claimant/Plaintiff/Petitioner The People of the State of New York by Andrew M. Cuomo, Attorney General of the State of New York.

Steiner, Neil A., Mennitt, Gary J. Esq., Levander, Andrew J., for Merkin, J. Ezra and Gabriel Capital Corporation.

Laffey, Casey D., Tulchin, Matthew T. Pitofsky, David B., for Ascot Partners L.P. (Relief Defendants).

Laffey, Casey D., Bensky, Eric A., Schiffman, Howard, for Ascot Fund Limited (Relief Defendants), Gabriel Capital L.P. (Relief Defendants), Ariel Fund Limited (Relief Defendants), Gabriel Assets LLC (Relief Defendants) and Gabriel Alternative Assets LLC (Relief Defendants).

Kaswan, Beth A., New York University, individually and derivatively (non-party).

RICHARD B. LOWE, J.

\*1 Defendants J. Ezra Merkin (“Merkin”) and Gabriel Capital Corporation (“GCC”) move for an order

dismissing the complaint pursuant to CPLR 3211 (a)(1) and (7).

The Attorney General (“AG”) is bringing this action against Merkin and his investment management company, based on violations of the Martin Act, Executive Law § 63(12), the Not-for-Profit Corporation Law and common-law claims. Allegedly, Merkin made misrepresentations and omissions to investors, including many charities, who entrusted him with their money. The AG further alleges that Merkin blindly fed the investors' funds into a Ponzi scheme orchestrated by Bernard L. Madoff (“Madoff”) while claiming that Merkin was actively managing those funds. Merkin also allegedly failed to conduct adequate due diligence of Madoff's activities, despite information given to him indicating that Madoff may have been engaged in misconduct. According to the complaint, Merkin's investors lost over \$1.2 billion, while he collected more than \$470 million in management and incentive fees from his funds including: Ascot Partners L.P., Ascot Fund Limited, Ariel Fund Limited, and Gabriel Capital L.P.

**BACKGROUND**

Accepting the allegations of the complaint as true (*Leon v. Martinez*, 84 N.Y.2d 83 [1994]), the following facts emerge: Defendant Merkin is the general partner of Ascot Partners, L.P. and Gabriel Capital, L.P. (“Gabriel”), domestic hedge funds. Merkin is the sole shareholder and director of GCC (Complaint, ¶¶ 16-17). GCC serves as the manager of Ascot Fund Limited (“Ascot”) and Ariel Fund Limited (“Ariel”), both of which are offshore funds. Merkin collected annual management fees equal to 1% of the capital invested in Ariel, Gabriel, and Ascot. In 2003, Merkin raised the Ascot management fee to 1.5% of the capital invested (*id.*, ¶ 24). He also collected an annual incentive fee of 20% of any appreciation in the assets of Gabriel and Ariel (*id.*).

26 Misc.3d 1237(A), 907 N.Y.S.2d 439, 2010 WL 936208 (N.Y.Sup.), Blue Sky L. Rep. P 74,821, 2010 N.Y. Slip Op. 50430(U)

**(Table, Text in WESTLAW), Unreported Disposition  
(Cite as: 26 Misc.3d 1237(A), 2010 WL 936208 (N.Y.Sup.))**

Merkin and Madoff met in the late 1980s, early 1990s (*id.*, ¶ 26). In the early 1990s, Madoff described to Merkin his investment strategy, known as a “split strike conversion strategy,” in which Madoff would buy stocks from the S & P's 100 Index, and simultaneously, buy put options below the current stock price to protect against large decreases, and sell call options above the current price to fund the purchase of the put options (*id.*, ¶ 27). Madoff claimed that he could produce steady returns of 10% per year no matter what the market was doing overall (*id.*).

In 1988, Merkin established Ariel and Gabriel (*id.*, ¶ 66). By 2008, Gabriel had approximately 200 investors with \$1.4 billion under management, and Ariel had 78 investors with about \$1.3 billion under management (*id.*). From 2001 to 2008, between 20-30% of the assets of Gabriel and Ariel were managed by Madoff (*id.*, ¶¶ 67-79). The remainder of the assets were not managed by Merkin, but by third parties (*id.*). From 1989 to 2007, Merkin collected annual management and incentive fees from Gabriel that totaled approximately \$277 million, and from Ariel approximately \$242 million (*id.*, ¶ 69).

\*2 According to the complaint, in 1992, Merkin created Ascot to serve solely as a feeder fund to Madoff, and substantially all of Ascot's assets were turned over to Madoff (*id.*, ¶ 32). Most of Ascot's investors were not aware that Ascot was a feeder fund for Madoff (*id.*, ¶ 33). Thirty-five non-profit organizations had invested \$215 million of the \$1.7 billion invested in Ascot by the end of 2008 (*id.*, ¶ 36). From 1995 through 2007, Merkin received management fees of \$169 million from the Ascot Fund (*id.*, ¶ 35), and by 2008, Merkin was receiving annual Ascot management fees of approximately \$25.5 million (*id.*).

The complaint alleges that after Madoff's arrest in December 2008, Merkin surprised Ariel and Gabriel investors by telling them, for the first time, that the funds had significant Madoff exposure. Thus, the Ariel and Gabriel investors were unaware of the

true nature of the investment they were making (*id.*, ¶ 99).

Based on these and other more specific allegations of misrepresentations and omissions by Merkin, the AG has brought six causes of action. The first through third claims are for securities fraud under the Martin Act, [General Business Law \[GBL\] § 352](#), [352-c \(1\)\(a\)](#) and (c), and [353](#). The fourth claim, alleged only against Merkin, asserts violations of the [Not-for-Profit Corporation Law §§ 112, 717, and 720](#). The fifth claim is for breach of fiduciary duty to the investors of Ascot, Ariel, and Gabriel, and seeks damages and disgorgement of compensation. The sixth claim, asserted under [Executive Law § 63 \(12\)](#), maintains that Merkin's and GCC's conduct constituted repeated fraudulent or illegal acts, or constituted persistent fraud in the transaction of business, and seeks restitution and damages.

The AG seeks to enjoin and restrain defendants from the alleged acts and practices, enjoin Merkin from serving as a general or managing partner, director or officer of any investment fund or otherwise managing investments, and enjoin him from serving as a board member, trustee, director or officer of any non-profit organization. The AG also seeks an accounting of all fees and other compensation, and to recover costs and attorneys' fees.

Merkin and GCC now move to dismiss the complaint in its entirety.

## DISCUSSION

On a motion to dismiss pursuant to [CPLR 3211](#), the court's task is to determine whether the complaint states a cause of action. The motion will be denied if, within the four corners of the pleading, factual allegations are discerned which taken together manifest a claim cognizable at law ( [511 West 232nd Owners Corp. v. Jennifer Realty Co.](#), 98 N.Y.2d 144, 151-152 [2002] ). The complaint will be liberally construed, and the court will accept as true all facts in the complaint and in plaintiff's sub-

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missions in opposition to the motion (*id.* at 152). Plaintiff will be accorded the benefit of all possible favorable inferences (*id.*). “Dismissal under CPLR 3211(a)(1) is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law” (“(*id.*, quoting *Leon v. Martinez*, 84 N.Y.2d at 88).

### *Martin Act and Executive Law Claims*

\*3 The Martin Act (General Business Law Article 23-A) prohibits various deceitful and fraudulent practices in the distribution, sale, exchange, and purchase of securities. Thus, it prohibits the use or employment of “[a]ny fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale” (General Business Law § 352-c [1][a]). It also prohibits:

(c) Any representation or statement which is false, where the person who made such representation or statement: (i) knew the truth; or (ii) with reasonable effort could have known the truth; or (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representation or statement made;

where engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of any securities or commodities, as defined in section three hundred fifty-two of this article, regardless of whether issuance, distribution, exchange, sale, negotiation or purchase resulted

(General Business Law § 352-c [1][c]). The Martin Act is remedial in nature and should be liberally construed (*People v. Lexington Sixty-First Assocs.*, 38 N.Y.2d 588, 595 [1976]). The terms “fraud” and “fraudulent practices” are given a broad meaning so that all deceitful practices, even acts “not originating in any actual evil design to perpetrate fraud or injury upon others, which do tend to deceive or mislead the purchasing public” are covered (*id.* at 595). In addition, the AG need not prove in-

tent or reliance in a Martin Act claim (*State of New York v. Sonifer Realty Corp.*, 212 A.D.2d 366, 367 [1st Dept 1995] [fraudulent practices need not constitute fraud in the classic common-law sense, and it is not necessary to show reliance]).

In support of the Martin Act claim, the AG has plead that Merkin concealed and failed to disclose Madoff's role, and misrepresented Merkin's role in the funds' management. For example, the AG alleges that the offering documents, such as the Ascot Memoranda, falsely represented that Merkin was involved in the fund's day-to-day management, and that the success of the fund depended on Merkin's abilities as a money manager. The Memoranda stated, for example, that he exclusively made the capital management decisions using his skill and experience, and that he would devote substantially all his time to managing its assets (Complaint, ¶¶ 39, 42-43). These documents could be construed as misrepresenting that Merkin would be controlling and actively managing the funds, and as concealing that Ascot was a feeder fund to Madoff (*id.*, ¶ 43).

The Ascot Memoranda, starting in 1996, indicated that multiple money managers might be used (*id.*, ¶ 45), which was false and misleading, because allegedly all of the funds were entrusted to a single money manager, Madoff (*id.*). The risk factors set forth in the Ascot Memoranda indicated a wide variety of investment strategies, none of which had anything to do with the “split strike conversion” strategy being employed by Madoff with the Ascot funds (*id.*, ¶ 46).

\*4 While in the March 2006 Ascot Offering Memorandum, Merkin mentioned Madoff's name, by indicating that Madoff, was one of Ascot's two prime brokers, and that he cleared Ascot's transactions effected through other brokerage firms, this allegedly misrepresented Madoff's role because 98% of Ascot's transactions were both effected and cleared by Madoff, and Madoff had custody of over 99% of Ascot's securities holdings (*id.*, ¶ 47). Therefore, based on these allegations, the AG has adequately pleaded that these misrepresentations

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constitute fraudulent practices under the Martin Act.

Where the Martin Act claims are based on the defendant's omissions or failure to disclose, the omitted facts must be material—that is, that there is a substantial likelihood that the omitted fact would have assumed actual significance in the deliberations of a reasonable investor ( *State of New York v. Rachmani Corp.*, 71 N.Y.2d 718, 726 [1988] ). “[T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix’ of information made available” ( *id.*, quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 [1976]; see also *State of New York v. McLeod*, 12 Misc.3d 1157[A] \*5, 2006 N.Y. Slip Op 50942[U] [Sup Ct, N.Y. County 2006] ).

With respect to Merkin's alleged omissions in failing to reveal Madoff's actual role, and the actual investment strategy being employed, the complaint sufficiently pleads that these omitted facts are material, that is, that there is a substantial likelihood that disclosure of these facts would have been viewed by the reasonable investor as having significantly altered the total mix of information made available (see *id.*, ¶¶ 56, 57, 59). Materiality is a mixed question of fact and law. Therefore, it is inappropriate for resolution at the motion to dismiss stage (see *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F3d 187, 197 [2d Cir2009]; *In re NovaGold Resources Inc. Sec. Litig.*, 629 F Supp 2d 272, 292 [SD N.Y.2009] ).

With regard to the Ariel and Gabriel Funds, the AG alleges misrepresentations with regard to the types of investments in which the funds would be involved. Thus, for example, the offering documents indicated that these funds focused on distressed debt and merger arbitrage, without disclosing that up to 30% of the funds were turned over to Madoff, who was using a completely different strategy.

In addition, the AG alleges misrepresentations and omissions regarding the ways in which the funds were going to operate. The offering documents indicated that Ariel did not use any self-clearing money managers. However, Madoff self-cleared all his transactions, and had custody of and managed a significant portion of Ariel's assets (*id.*, ¶ 82). Ariel's November 2002 Prospectus stated that brokers for the funds would not perform managerial or policy-making functions for the Fund (*id.*, ¶ 83, and Exhibit 23 annexed thereto). Madoff, however, was performing such managerial functions, and effecting, clearing, and settling transactions, all at the same time (*id.*, ¶¶ 83-84). The March 2006 Offering Memorandum stated that Morgan Stanley was the principal prime broker for Ariel, but this was false and misleading, because Morgan Stanley did not clear Madoff's trades, and was not the custodian for securities managed by Madoff.

\*5 The AG also alleges oral misrepresentations by Merkin in which he or his employees denied that Ascot was managed by Madoff, denied that they were doing the same thing as Madoff, or minimized Madoff's role. The complaint also asserts that Merkin also made oral misrepresentations to an investor who was aware that Madoff was involved in Ascot, that Merkin required BDO Seidman, Ascot's auditor, to visit Madoff's offices two or three times a year to perform standard operational due diligence. In fact, however, BDO did not perform such due diligence or any other examination of Madoff's operation (*id.*, ¶ 63). The Ascot Subscription Agreement provided that the investors were given the opportunity to ask questions of, and receive answers from, the General Partner (Merkin and GCC) concerning matters pertaining to the investment. This essentially gives the investors the right to rely upon information the General Partner conveyed to the investor, orally or otherwise (see *Heller v. Goldin Restructuring Fund, L.P.*, 590 F Supp 2d 603, 615 [SD N.Y.2008] ). Taken together, all of these alleged oral and written misrepresentations sufficiently state a claim for fraudulent practices under the Martin Act.

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The defendants' reliance on a provision in the 2006 Offering Memoranda that Merkin might delegate investment management duties to independent money managers without first providing notice to, or obtaining the consent of, investors, is misplaced. They contend that any alleged misrepresentations were sufficiently balanced by this cautionary language. Defendants appear to be relying upon the "bespeaks caution" doctrine set forth in federal securities cases, which are persuasive authority in determining Martin Act claims (*see e.g. All Seasons Resorts, Inc. v. Abrams*, 68 N.Y.2d 81, 87 [1986] [in applying Martin Act, federal securities law cases are persuasive authority] ). Under this doctrine, misrepresentations or omissions "in conjunction with the purchase or sale of securities are considered immaterial where contained in communications or documents including cautionary language sufficiently specific to render reliance on the false or omitted statement unreasonable" ' and not actionable ( *United States SEC v. Meltzer*, 440 F Supp 2d 179, 191 [ED N.Y.2006] [citations omitted]; *see Halperin v. eBanker USA.com, Inc.*, 295 F3d 352, 357 [2d Cir2002] ). Generalized disclosures regarding unspecified risks, however, will not shield defendants from liability. Instead, regarding the prospective representations, the cautionary language must expressly warn of, and be specific and factual ( *Halperin v. eBanker USA.com, Inc.*, 295 F3d at 359). This doctrine is limited to forward-looking statements only, and is not applied to misrepresentations of present or historical facts which cannot be cured by cautionary language ( *P. Stolz Family Partnership L.P. v. Daum*, 355 F3d 92, 96-97 [2d Cir2004] ). The cautionary language warns investors that "bad things may come to pass-in dealing with the contingent or unforeseen future" (*id.* at 97). It, therefore, does not apply to historical or present fact knowledge, because "[s]uch facts exist and are known; they are not unforeseen or contingent" (*id.*). An offeror may not knowingly misrepresent historical facts and at the same time disclaim the misrepresented facts with cautionary language ( *id.*; *Gabriel Capital, L.P. v. NatWest Fin., Inc.*, 122 F Supp 2d 407, 419 [SD N.Y.2000], *abrogated on*

*other grounds In re IPO Securities Litigation*, 241 F Supp 2d 281, 352 n 85 [SD N.Y.2003] [a defendant cannot use the bespeaks caution doctrine where it knew that its statement was false when made] ).

\*6 The misrepresentations at the center of this complaint involve Madoff's role as the manager of all of Ascot's funds and a substantial portion of Ariel's and Gabriel's funds. Merkin gave Madoff complete control and investment discretion over all of Ascot's and a substantial portion of Ariel's and Gabriel's funds. Thus, he had already delegated all investment discretion to this money manager, a fact Merkin was presently aware of at the time of the Offering Memoranda. In addition, given that Merkin admitted that he formed Ascot for the purpose of investing with Madoff and that virtually all of its assets were tendered to him, to the extent that the representations that Merkin would exercise discretion in managing the funds, and the performance of the funds depended on his skill and judgment could be construed "as to the future," the misrepresentations were "beyond reasonable expectation" (GBL § 352-c [1] [b] ). The reference to Madoff's role as a prime broker, as mentioned above, was misleading because such brokers do not make investment management decisions like Madoff was making, and the mischaracterization of Madoff's role was a historical, present known fact. Further, particularly with regard to Ariel and Gabriel, the misrepresentation regarding their present investment strategy of investing in distressed businesses, also referred to a false historical fact. Defendants have failed to show that no reasonable investor could have been misled about the nature of the risk when he or she invested ( *P. Stolz Family Partnership, L.P. v. Daum*, 355 F3d at 97). This cautionary language also does not address the other misrepresentations and omissions, such as Merkin's failure to exercise judgment in supervising the delegation of investment management to Madoff, his failure to conduct due diligence, and to audit Madoff's activities regarding the funds, and the fact that Merkin ignored the warnings of fraud from his own people and from fund investors. Therefore, the existence of the cautionary language

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does not negate the materiality of the misrepresentations and omissions alleged in the complaint.

The documentary evidence submitted by defendants, consisting of e-mails from about 10 investors, indicating that these investors were aware that monies were invested with Madoff, fail to demonstrate that dismissal is warranted at this early stage of this action. Whether some of the investors of Ascot, Ariel, and Gabriel were aware that the funds were invested with Madoff, does not bar the AG's claims. The complaint details claims that hundreds of investors were not so aware and therefore the e-mails do not provide a basis for dismissal as a matter of law. Finally, defendants' argument that dismissal is warranted on the ground that the AG cannot show loss causation is also rejected. Loss causation is not an element of a Martin Act claim. A misrepresentation may violate the statute "regardless of whether issuance, distribution, exchange, sale, negotiation or purchase resulted" (GBL § 352-c [1][c]; *State of New York v. Sonifer Realty Corp.*, 212 A.D.2d at 367). Therefore, the first through third causes of action for violations of the Martin Act are sufficient to withstand this motion to dismiss.

\*7 The AG's Executive Law claim similarly survives this dismissal motion. Executive Law § 63 (12) gives the AG the power to bring a claim against any person or entity which engages in "repeated fraudulent or illegal acts" or "otherwise demonstrate[s] persistent fraud or illegality in the carrying on ... or transaction of business." Like the Martin Act, the statute broadly construes the definition of fraud "so as to include acts characterized as dishonest or misleading and eliminating the necessity for proof of an intent to defraud" (*People v. Apple Health and Sports Clubs, Ltd.*, 206 A.D.2d 266, 267 [1st Dept], *lv dismissed in part, denied in part* 84 N.Y.2d 1004 [1994]; see *People v. General Elec. Co.*, 302 A.D.2d 314 [1st Dept 2003] ). The test for fraud thereunder is whether the acts have the capacity or tendency to deceive, or creates an atmosphere conducive to fraud (*People v. General Elec. Co.*, 302 A.D.2d at 314). Like the Martin Act,

since the repeated fraudulent practices targeted by the statute do not need to constitute fraud in the classic common-law sense, reliance need not be shown (*State of New York v. Sonifer Realty Corp.*, 212 A.D.2d at 367). The AG may apply for an injunction, and seek restitution and damages (Executive Law § 63[12]).

As in the Martin Act claims, the allegations here are sufficient to satisfy Executive Law § 63(12). As determined above with regard to the Martin Act claims, Merkin's representations, as alleged in the pleadings, were fraudulent and his omissions were material. In addition, the AG has alleged that the defendants engaged in "repeated" and/or "persistent" fraudulent acts in violation of Executive Law § 63(12). Again, the AG need not show reliance or loss causation with respect to this claim. Therefore, the defendants' motion with regard to the sixth cause of action is denied.

#### ***Not-for-Profit Law Claim***

The AG's fourth claim is for violations of the Not-for-Profit Corporation Law §§ 112, 717, and 720. In this claim, the AG alleges that Merkin failed to discharge his duties as an officer or director of "Merkin-Affiliated Non-Profits" with the degree of care, skill, and diligence that an ordinarily prudent person in his position would exercise (Complaint, ¶ 133). These failures included that he received a personal benefit from investments made by "Non-Profit Organizations A, C, and G," failed to disclose that he was actively earning his management fees, failed make diligent inquiries into the risks of investing with Madoff, ignored numerous indications that Madoff was engaging in fraud, and failed to disclose his conflicts of interest (*id.*). The complaint alleges that Merkin was an officer, director, trustee and sat on the investment committees of three non-profits, and collected a personal benefit from the investments made by the two entities referred to as Non-Profit Organizations A and C, on whose board of directors' investment committees he sat, and a third, referred to as Non-Profit Organiza-

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tion G, for which he served as investment advisor (*id.*, ¶ 5, 65, 120-124, 133). It alleges that Merkin was such a regular at the Investment Committee meeting of Non-Profit Organization G that he was “referred to as the Chair in the minutes,” and, as this organization's investment advisor, he created a special relationship of trust as its fiduciary (*id.*, ¶ 123). It further asserts that Merkin and Madoff both were on the Board of Trustees of Non-Profit Organization A, which had a large investment in Ascot. The complaint alleges that Merkin breached his fiduciary duty by accepting Non-Profit Organization A's investment in Ascot, where he would earn a significant management fee, when Merkin could have arranged for a direct investment with Madoff without the extra fees (*id.*). The AG further alleges that Merkin breached his fiduciary duties by concealing Madoff's role in Ascot, Ariel, and Gabriel, by failing to disclose conflicts of interest Merkin had in recommending investments, and by making false statements regarding his fee structure. The complaint asserts that Merkin's conduct breached his fiduciary duties in violation of sections 112, 717, and 720 of the Not-for-Profit Corporation Law (N-PCL).

\*8 Defendants challenge this claim, asserting that the AG has failed to plead specifically the non-profit corporation of which Merkin was an officer or director. They contend that the complaint only alleges that he was a trustee of Non-Profit Organization A, and that he sat on the investment committees and served as an investment advisor with regard to Non-Profit Organizations C and G.

N-PCL § 112 authorizes various remedial measures that may be pursued in an action or special proceeding brought by the AG under the N-PCL (N-PCL § 112). Section 720 provides that an action may be brought against a director or officer of a not-for-profit corporation to compel the defendant to account for neglect, failure to perform, or other violation of his duties in the management of corporate assets, and the acquisition by himself or transfer to others, loss, or waste of corporate assets due to

neglect of, failure to perform, or other violation of his duties (N-PCL § 720). Section 720(b) specifically provides that the AG may bring an action for the relief provided in the section.

The fiduciary duties of care and loyalty are the legal standards that govern the conduct of not-for-profit directors and officers in their daily relationship with the not-for-profit corporation they serve (N-PCL § 717 [a]). Section 102(a)(6) of the N-PCL defines “director” to mean “any member of the governing board of a corporation, whether designated as director, trustee, manager, governor, or by any other title. The term board' means board of directors' (N-PCL § 102[a][6]).

The complaint, here, adequately pleads that Merkin was a trustee of Non-Profit Organization A, which falls within the definition of director under N-PCL § 102(a)(6). Defendants' submission, at oral argument,<sup>FN1</sup> of the minutes of a meeting of the Board of Trustees for Yeshiva University, which defendants claim is Non-Profit Organization A, at which Merkin attended and spoke as a member of the Board's Investment Committee, supports this conclusion. With regard to the other non-profit organizations designated C and G, this court will not dismiss the claim at this early stage of the litigation. The allegations that Merkin sat on the investment committees of these organizations, and was their investment advisor, even being referred to at one meeting as “Chair,” is sufficient at this point.

FN1. Both parties acknowledge that the documents submitted at oral argument on October 15, 2009 before this court, are subject to a confidentiality stipulation between the parties. Therefore, they will be returned to the defendants. However, the defendants are directed to file redacted copies of these documents for the court file.

Moreover, contrary to defendants' argument, Merkin's alleged breaches of his fiduciary duty, as set forth above, are sufficiently specific. Defendants'

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contention that the claim of undisclosed conflicts of interest should be dismissed based on documentary evidence they submit, is rejected. While the documents submitted at oral argument indicate that Merkin disclosed to Yeshiva University in March 2001 and March 2002 that he had conflicts with regard to Ascot, indicating the fees he collected, it is not clear whether this disclosure was made to the other non-profit corporations (C and G), and it is not clear if Yeshiva University also invested in Ariel and Gabriel, and whether Merkin's fees and conflicts with regard to Ariel and Gabriel were disclosed to any of the Merkin affiliated non-profit corporations. Therefore, because the defendants' documentary evidence does not clearly refute all of the assertions regarding Merkin's failures under the N-PCL, the court concludes that the motion to dismiss this claim also must fail.

#### **Breach of Fiduciary Duty Claim**

\*9 The breach of fiduciary duty claim also survives defendants' motion. In this claim, the AG alleges that Merkin utterly failed to manage, supervise, or monitor the investments of Ascot, Ariel, and Gabriel, as he was obligated to as their investment manager. By turning over the funds to Madoff without conducting adequate due diligence, despite information given to Merkin by his own associates, as well as some of the funds' investors, indicating that Madoff may have been engaged in misconduct (*see* Complaint, ¶¶ 107-115), Merkin breached his fiduciary duties to the funds and the investors. The complaint also alleges that while Merkin was aware of certain aspects of Madoff's operations that raised the possibility of fraud by Madoff, including Madoff's use of paper trade confirmations, the secrecy of Madoff's operations, the fact that Madoff was self-clearing, and that his operations were controlled exclusively by himself and close family members (*id.*, ¶ 116), Merkin never questioned Madoff's operations.

Defendants challenge this claim on several grounds. First, they claim that the AG does not have *parens*

*patriae* standing. *Parens patriae* is a common-law doctrine regarding standing. It allows the state to bring an action to prevent harm to its sovereign interests, such as the health, safety, comfort, and welfare of its citizens. To invoke the doctrine, the AG must show: (1) a quasi-sovereign interest in the public's well-being; (2) distinct from that of a particular private party; and (3) injury to a sufficiently substantial segment of the population (*see Alfred L. Snapp & Son, Inc. v. Puerto Rico, ex rel., Barez*, 458 U.S. 592, 607 [1982]; *see also People v. Grasso*, 11 NY3d 64, 69, n 4 [2008] ). A "quasi-sovereign interest" has been held to consist of a set of interests which the state has in the well-being of its populace" (*State of New York v. McLeod*, 12 Misc.3d 1157[A], \*10, 2006 N.Y. Slip Op 50942[U] ). Courts have held that "a state has a quasi-sovereign interest in protecting the integrity of the marketplace" ( *People v. Grasso*, 11 NY3d at 69 n 4, citing *State of New York v. General Motors Corp.*, 547 F Supp 703 [SD N.Y.1982]; *People v. H & R Block, Inc.*, 16 Misc.3d 1124[A], 2007 N.Y. Slip Op 51562 [U] [Sup Ct, N.Y. County 2007] [Moskowitz, J.], *affd* 58 AD3d 415, 417 [1st Dept 2009] ).

Here, the recovery of damages for aggrieved investors is just a part of the AG's case. The AG's focus is on obtaining injunctive relief designed to "vindicate the State's quasi-sovereign interest in securing an honest marketplace for all consumers" ( *People v. H & R Block, Inc.*, 16 Misc.3d 1124 [A],\* 7, 2007 N.Y. Slip Op 51562[U] ). Specifically, the AG has identified a strong quasi-sovereign interest in ensuring that the "financial markets as a whole, and the hedge fund industry in particular, operate honestly and transparently" (AG's Memorandum of Law, at 23; *see People v. H & R Block, Inc.*, 58 AD3d at 417 ["New York's vital interest in securing an honest marketplace in which to transact business" was a sufficient basis for *parens patriae* standing]; *People v. Liberty Mut. Ins. Co.*, 52 AD3d 378, 379 [1st Dept 2008]; *see also People v. Coventry First LLC*, 2007 WL 2905486 [Sup Ct, N.Y. County 2007], *affd as mod* 52 AD3d 345, 346 [1st

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Dept 2008], *affd* 13 NY3d 108 [2009] [upholding parens patriae standing to secure honest marketplace for claims including breach of fiduciary duty]. The fact that the AG is seeking recovery on behalf of an identifiable group of investors, here, does not require this court to ignore the purpose of this breach of fiduciary duty claim, and to characterize it, as defendants do, as one brought solely to benefit a few private investors (*see People v. H & R Block, Inc.*, 16 Misc.3d 1124[A], \* 7, 2007 N.Y. Slip Op 51562[U]; *see also State of New York v. General Motors Corp.*, 547 F Supp at 706-707).

\*10 With respect to injury to a substantial segment of the population, Merkin's alleged misconduct touched many investors, many of whom are New York State residents. They were not just individuals, but also funds and financial institutions representing individuals, charities, and foundations. This is sufficient to show injury to a substantial segment of the population (*see People v. Liberty Mut. Holding Co.*, 2007 WL 900997 [Sup Ct, N.Y. County 2007], *affd as mod* 52 AD3d 378 [1st Dept 2008]). Defendants' contention that the AG must show an inability of the allegedly injured individuals to obtain relief in a private suit, is without merit. Case law does not demonstrate such a requirement (*see Alfred L. Snapp & Son, Inc. v. Puerto Rico, ex rel., Barez*, 458 U.S. 592, *supra*). The fact that some private investors may choose to pursue or not to pursue claims on their own behalf does not detract from the substantial public interest at stake in this action. In addition, it is unclear whether all of the investors can obtain individual relief. Therefore, the AG has shown a sufficient basis for parens patriae standing with regard to the breach of fiduciary duty claim.

The defendants also contend that the Martin Act preempts this claim. They fail, however, to cite cases in support of this argument and this court has found no precedent holding that the Martin Act preempts the AG from bringing a common-law claim. The Martin Act cases to which defendants do cite involve claims brought by private parties, in

which, under certain circumstances, the courts find that to allow such a claim would circumvent the bar to private actions under the Martin Act (*see Horn v. 440 East 57th Co.*, 151 A.D.2d 112, 120 [1st Dept 1989]; *In re Bayou Hedge Fund Litig.*, 534 F Supp 2d 405 [SD N.Y.2007], *affd* 573 F3d 98 [2d Cir2009]; *Kassover v. UBS AG*, 619 F Supp 2d 28 [SD N.Y.2008] [AG has exclusive jurisdiction to enforce the Martin Act]; *but see Caboara v. Babylon Cove Dev., LLC*, 54 AD3d 79 [2d Dept 2008] [individual's common-law fraud claim, resting on same facts as Martin Act, not preempted, so long as satisfies pleading standards]; *Scalp & Blade, Inc. v. Advest, Inc.*, 281 A.D.2d 882, 883 [4th Dept 2001] [breach of fiduciary duty claim not preempted by Martin Act). The Martin Act preemption doctrine is to preserve the AG's exclusive jurisdiction to enforce the statute, and to permit the claim here does not undermine that exclusive enforcement jurisdiction. In fact, the AG has pursued Martin Act claims along with common-law claims, including claims for breach of fiduciary duty (*see e.g. People v. Coventry First LLC*, 13 NY3d 108, *supra* [Martin Act claims and breach of fiduciary duty and fraud claims permitted to proceed together]; *compare People v. H & R Block, Inc.*, 158 AD3d 415, *supra* [Executive Law § 63(12) claims pursued with breach of fiduciary duty and fraud claims]).

Defendants' reliance on *People v. Grasso* (11 NY3d at 70) to urge that the principles that govern private parties regarding preemption based on the Martin Act, must be applied to the AG's claim here, is misplaced. The *Grasso* case was brought by the AG under the N-PCL. The AG asserted non-statutory claims against Richard Grasso, as an officer or director of a non-profit corporation, the NYSE, based on specific provisions of the N-PCL. The Court determined that the Legislature's comprehensive enforcement scheme in the N-PCL required a finding of fault-that the officer or director lacked good faith in executing his duties. It found that the non-statutory claims asserted in that action, based on specific N-PCL statute provisions, were devoid of any

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fault-based elements. Thus, the nonstatutory claims had a lower burden of proof than that specified by the statute, overriding the Legislature's fault-based scheme. As such, the Court found that they were fundamentally inconsistent with the N-PCL, and reached beyond the bounds of the AG's authority. In the instant case, the breach of fiduciary duty claim is not based specifically on any Martin Act provisions, or, for that matter, on any provisions in the N-PCL. Moreover, the Martin Act, like the breach of fiduciary duty claim, does not require deceitful intent (see *Horn v. 440 East 57th Co.*, 151 A.D.2d at 120). Therefore, there is no inconsistency between the statutory Martin Act claims, and the breach of fiduciary duty claim. Finally, the fifth cause of action sufficiently states a claim for breach of fiduciary duty. To state a claim for breach of fiduciary duty, a plaintiff must plead: (1) the existence of a fiduciary duty between the parties; (2) a breach of that duty; and (3) damages resulting from the breach (see *People v. H & R Block, Inc.*, 16 Misc.3d 1124[A], \* 7, 2007 N.Y. Slip Op 51562[U]). The AG has adequately pled this claim against Merkin by asserting that, as the General Partner of Ascot Partners and Gabriel Capital, L.P., the two domestic funds, he had fiduciary duties to his investors. In fact, in his testimony to the AG, Merkin admitted that he had "fiduciary responsibilities for oversight of the portfolios" (Complaint, ¶ 24 and Exhibit 1 annexed thereto, at 101). With regard to the offshore funds, Ariel and Ascot Fund Limited, investment advisors, such as Merkin, owe fiduciary duties to their clients, particularly where the investment advisor has broad discretion to manage the client's investments (see *EBC I, Inc. v. Goldman Sachs & Co.*, 5 NY3d 11, 19-20 [2005] [underwriter as expert advisor with regard to market conditions held to owe fiduciary duty]; *Brooks v. Key Trust Co. Natl. Assn.*, 26 AD3d 628 [3d Dept 2006], lv dismissed 6 NY3d 891 [2006] [financial advisor with discretionary authority to act owes a fiduciary duty]; *Rasmussen v. A.C.T. Environmental Services Inc.*, 292 A.D.2d 710, 712 [3d Dept 2002] [investment advisor owes fiduciary duty]; *Bullmore v. Banc of Amer. Securities LLC*, 485 F

Supp 2d 464, 470-471 [SD N.Y.2007]; *Fraternity Fund Ltd. v. Beacon Hill Asset Management LLC*, 376 F Supp 2d 385, 413-414 & n 182 [SD N.Y.2005] [collecting cases] ). Individuals in positions of trust, such as "investment advisors, are subject to liability for breach of fiduciary duty when they deceive or defraud their clients" ( *Bullmore v. Banc of Am. Securities LLC*, 485 F Supp 2d at 471). Merkin was the investment advisor and manager to the investors of all four of the funds, and he had complete discretion with regard to how the monies were invested. The relationship created by the Offering Documents imposed on Merkin a duty to act with care and loyalty independent of the terms of those agreements.

\*11 Defendants urge that this claim should be dismissed because it may not be asserted individually by shareholders of a Cayman Islands corporation. *Fraternity Fund Ltd. v. Beacon Hill Asset Management LLC* (376 F Supp 2d 385, *supra*) is instructive. In that case, individual investors in hedge funds sued the limited liability companies issuing the funds and their principals, alleging, among other claims, that the defendants had breached their fiduciary duties to the investors. The court rejected the defendants' argument that the wrong belonged only to the corporation. It found that the wrong was a fraud committed on the shareholders rather than on the funds, in that defendants had fraudulently overstated the net asset value of the funds, concealing the declines in the fund assets, and the investors were injured when they invested or retained their investments in reliance upon the misstatements (*id.* at 409). Here, the wrongs alleged include Merkin's misrepresentations and omissions regarding what the investors were investing in, and what his role would be in managing the funds, his affirmative misrepresentations to investors after he had already delegated all authority and discretion to Madoff, and his failure to perform due diligence and ignoring signs of fraud. These alleged wrongs were a fraud committed on the shareholder investors rather than on the funds, and the investors were injured when they invested or retained their investments in

26 Misc.3d 1237(A), 907 N.Y.S.2d 439, 2010 WL 936208 (N.Y.Sup.), Blue Sky L. Rep. P 74,821, 2010 N.Y. Slip Op. 50430(U)

**(Table, Text in WESTLAW), Unreported Disposition  
(Cite as: 26 Misc.3d 1237(A), 2010 WL 936208 (N.Y.Sup.))**

reliance upon the misstatements.

END OF DOCUMENT

Defendants' argument that there was no breach because the documents permitted Merkin to delegate his duties to other money managers without notice, lacks merit. The breach of fiduciary duty is not that he was permitted to and did delegate to other money managers. The breach alleged is based on Merkin's misrepresentations regarding his role in purportedly managing the funds and in conducting due diligence with regard to the investments, and in his concealment, both before and after the delegation of all or a portion of the funds to Madoff, that the funds were with Madoff. To the extent that the Offering Documents and Partnership Agreements with regard to Gabriel and Ascot Partners provide that Merkin's liability is limited to "bad faith, gross negligence, recklessness, fraud, or intentional misconduct" the breach of fiduciary duty claim for those investors may be so limited.

### *Injunctive Relief*

Finally, defendants fail to demonstrate a basis to strike the AG's request for injunctive relief. It is entirely premature to determine whether the AG will be entitled to an injunction, and the extent of any such injunction under the Martin Act, the [Executive Law § 63\(12\)](#), or the Not-for-Profit Law. The exact nature of injunctive relief that may be awarded will await further determination of the claims.

### *CONCLUSION*

The court has considered the remainder of defendants' arguments and finds them to be without merit.

Accordingly, the motion to dismiss is denied in its entirety.

N.Y.Sup.,2010.

People ex rel. Cuomo v. Merkin

26 Misc.3d 1237(A), 907 N.Y.S.2d 439, 2010 WL 936208 (N.Y.Sup.), Blue Sky L. Rep. P 74,821, 2010 N.Y. Slip Op. 50430(U)

**UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**

SECURITIES INVESTOR PROTECTION CORPORATION,  
Plaintiff,  
- against -  
BERNARD L. MADOFF INVESTMENT SECURITIES LLC,  
Defendant.

---

In re:  
BERNARD L. MADOFF INVESTMENT SECURITIES LLC,  
Debtor.

---

IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC,  
Plaintiff,  
- against -  
ERIC T. SCHNEIDERMAN, as successor to ANDREW M. CUOMO, Attorney General of the State of New York; BART M. SCHWARTZ, as Receiver for ARIEL FUND LTD. and GABRIEL CAPITAL, L.P.; DAVID PITOFSKY, as Receiver for ASCOT FUND, LTD.; J. EZRA MERKIN; and GABRIEL CAPITAL CORPORATION,  
Defendants.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

Adv. Pro. No. 12-01778

**DECLARATION OF BART M. SCHWARTZ IN SUPPORT  
OF JOINT MOTION TO WITHDRAW THE REFERENCE**

BART M. SCHWARTZ, under penalty of perjury, declares the following to true and correct:

1. I am a member of the bar of this Court. I serve as the Ariel & Gabriel Receiver, as defined in the Joint Memorandum of Law in Support of Motion to Withdraw the Reference of the above-captioned Adversary Proceeding, in support of which I submit this declaration. All capitalized terms used, but not otherwise defined, herein shall have the meanings ascribed to them in that filing.

2. I respectfully refer to the Motion, and the Declaration of David Ellenhorn also submitted in support thereof, for fuller descriptions of the factual background and relevant legal points pertaining to this matter.

**The Ariel & Gabriel Funds, and Their Investors**

3. I submit this declaration to emphasize the adverse impact of filing, and ongoing pendency, of the Stay Action on investors in each of the funds for which I serve as Receiver: Ariel Fund, Ltd. (“Ariel Fund”) and Gabriel Capital, L.P. (“Gabriel Fund” and together with Ariel Fund, the “Ariel & Gabriel Funds”).

4. The Ariel & Gabriel Funds collectively have nearly 300 investors, ranging from elderly individuals (many of whom I understand are now of relatively modest means, following the losses they sustained through their investments in one or both of the Ariel & Gabriel Funds, and in some instances other market impacts of 2008 and thereafter); to charities and endowments, both within and outside of New York; to relatively large financial management organizations (each of which ultimately is investing the monies of underlying individuals).

5. As noted in the Motion, the Merkin Defendants invested between 25 and 30% of the assets of each of the Ariel & Gabriel Funds with BLMIS.

6. In addition to causes of action against the Merkin Defendants and other parties, and disputed claims against BLMIS, substantial, but largely illiquid, assets existed in each fund at the time of my appointment as Ariel & Gabriel Receiver.

7. Since my appointment as the Ariel & Gabriel Receiver, I have worked diligently to carefully and expeditiously liquidate the Ariel & Gabriel Funds' non-BLMIS investment portfolios without unduly sacrificing investment value, seeking to maximize both the speed and aggregate amount of distributions to investors. To date, I have secured approval from Justice Richard B. Lowe, III, of the New York State Supreme Court, to distribute more than \$500,000,000 to investors in the Ariel & Gabriel Funds, subject to investor eligibility.

**The Ariel & Gabriel Funds' Litigations With BLMIS**

8. I also have worked throughout my service as Ariel & Gabriel Receiver to achieve reasonable resolutions of all disputes, to the extent possible, in the interests of investors in the Ariel & Gabriel Funds. In this regard, I first communicated with the Trustee shortly after my appointment in 2009, in an effort to determine the feasibility and advisability of any consensual resolution of the Trustee's claims of \$16 million to \$18 million against each of the Ariel & Gabriel Funds, and allowance of the Ariel & Gabriel Funds' net equity claims against BLMIS, each in an amount exceeding \$160 million.

9. Immediately after my first meetings with the Trustee, he amended BLMIS' claims against the Ariel & Gabriel Funds to increase them by more than \$275,000,000. However, following my prompt filing of a motion to dismiss, the Trustee voluntarily withdrew these additional claims, and was quoted in a *Bloomberg* article on the subject on November 7, 2009, as having decided to do so "following further review of the law." Eric Larson, "*Madoff Trustee*

*Drops \$279 Million From Claim Against Merkin*”, BLOOMBERG, November 7, 2009,

[http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aebYeET87\\_BQ](http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aebYeET87_BQ).

10. Notwithstanding multiple meetings and other communications over the past three years, to date no settlement has been reached between the Ariel & Gabriel Funds and BLMIS.

**The Ariel & Gabriel Funds’ Litigations and Settlement With the Merkin Defendants**

11. Similarly, promptly following my appointment I began to explore the possibility of a consensual resolution of claims that the Ariel & Gabriel Funds possessed against the Merkin Defendants. In addition to the NYAG Action, when a settlement had not been reached between the Ariel & Gabriel Funds and the Merkin Defendants in advance of the two year anniversary of the funds’ collapse, I commenced my own action on behalf of the Ariel & Gabriel Funds against the Merkin Defendants.

12. After substantial negotiations, as described in some detail in the Declaration of David Ellenhorn also filed in support of the Motion, I agreed in December 2011, on behalf of the Ariel & Gabriel Funds, to a settlement with the Merkin Defendants. Upon failure of that settlement – due, as described in greater detail in the Declaration of David Ellenhorn, to the inability to secure releases for the Ariel & Gabriel Funds, the Ascot Funds, and the Merkin Defendants from the Trustee – I participated in further negotiations with the Merkin Defendants, resulting ultimately in the Merkin Settlement.

13. While I have thus far been able to return relatively meaningful amounts to investors from the non-BLMIS portions of the Ariel & Gabriel Funds’ portfolios, none of these investors has received any recovery from the Ariel & Gabriel Funds, nor to my knowledge from any other source, in respect of their net cash losses attributable to the funds’ BLMIS investments.

Specifically, none of the investors in the Ariel & Gabriel Funds are eligible, nor will they ever be eligible, to receive SIPC payments in respect of their Ariel & Gabriel Funds investments.

14. Pursuant to the Merkin Settlement, each eligible investor in either of the Ariel & Gabriel Funds who elects to participate will receive 42.5% of the first \$5 million of their net BLMIS losses. Large investors (defined as investors with more than \$5 million in net BLMIS losses) may submit to a simple process which will determine whether they knew that Merkin had delegated investment responsibility to BLMIS. Those large investors who were not aware of this delegation may participate in a 'large investor settlement pool' which could provide up to 42.5% of their net BLMIS losses *above* \$5 million. (Large investors who do not wish to participate in this claims process or had knowledge of BLMIS' role and do not seek to qualify, will instead receive an additional 2.5% of their net BLMIS losses above \$5 million.) The Trustee incorrectly asserts in the Stay Action that this process will be "complex" and "costly." In fact, it is expected to involve only a few investors. The process will be overseen by an independent settlement fund administrator, and is expected to be conducted efficiently and at modest cost.

**The Ongoing Harm Caused to Investors in the Ariel & Gabriel Funds by the Stay Action**

15. Prior to commencement of the Stay Action, I, along with the NYAG and the Ascot Receiver, were preparing to consummate the Merkin Settlement, and transmit solicitation materials to all investors. Absent commencement of the Stay Action, we projected that the first distributions would be made to eligible investors during the first quarter of 2013.

16. The commencement, and ongoing pendency, of the Stay Action, has thwarted our ability to move forward with consummation of the Merkin Settlement, and the making of distributions from proceeds thereof to investors. This visits further delay and burden upon

individual investors who already have waited nearly four years following the collapse of the Ariel & Gabriel Funds to receive any recompense for the funds' BLMIS losses.

17. For these reasons, beyond its absence of legal merit, as discussed in detail in the Motion, I view the filing and ongoing prosecution of the Stay Action as a fundamentally unjust further attack on the already injured investors of the Ariel & Gabriel Funds.

18. I look forward to the opportunity to have the Stay Action heard and decided promptly before a Court with full authority to enter dispositive rulings on the relief requested – rulings which I respectfully submit should result in dismissal of the Stay Action in its entirety.

Dated: August 31, 2012  
New York, New York

/s/Bart M. Schwartz  
Bart M. Schwartz

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

SECURITIES INVESTOR PROTECTION  
CORPORATION,

Plaintiff,

- against -

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

In re:

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Debtor.

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

Plaintiff,

- against -

ERIC T. SCHNEIDERMAN, as successor to  
ANDREW M. CUOMO, Attorney General of the  
State of New York; BART M. SCHWARTZ, as  
Receiver for ARIEL FUND, LTD. and GABRIEL  
CAPITAL, L.P.; DAVID PITOFISKY, as Receiver  
for ASCOT PARTNERS, L.P., and ASCOT FUND,  
LTD.; J. EZRA MERKIN; and GABRIEL  
CAPITAL CORPORATION,

Defendants.

Adv. Pro. No. 12-01778

**DECLARATION OF JAMES C. MCCARROLL IN  
SUPPORT OF JOINT MOTION TO WITHDRAW  
THE REFERENCE OF THE ABOVE-CAPTIONED ADVERSARY PROCEEDING**

JAMES C. McCARROLL, under penalty of perjury, declares the following to true and correct:

1. I am a member of the bar of this Court and a partner in the firm of Reed Smith LLP, counsel for Defendant Bart M. Schwartz, as Receiver of Ariel Fund, Ltd. and Gabriel Capital, L.P. I submit this Declaration in support of the Joint Motion to Withdraw the Reference (the "Motion"), and to place before the Court true and correct copies of documents concerning the Motion and referenced in the accompanying Joint Memorandum of Law in Support of Motion to Withdraw the Reference.

2. Attached hereto as Exhibit A is a true and correct copy of the Stay Complaint.<sup>1</sup>

3. Attached hereto as Exhibit B is a true and correct copy of the Injunction Motion.

4. Attached hereto as Exhibit C is a true and correct copy of Marc E. Hirschfield, *Barton Doctrine: Still Kicking After 130 Years*, ABI JOURNAL, Aug. 2012.

5. Attached hereto as Exhibit D is a true and correct copy of the complaint filed by the Ariel & Gabriel Receiver against the Merkin Defendants.

6. Attached hereto as Exhibit E is a true and correct copy of the Avoidance Action Complaint.

7. Attached hereto as Exhibit F are true and correct copies of the prior withdrawal motions filed by the Receivers and the Merkin Defendants.

8. Attached hereto as Exhibit G are true and correct copies of the Stay Orders.

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<sup>1</sup> Capitalized terms not defined herein shall have the meanings ascribed in the Joint Memorandum of Law in Support of Motion to Withdraw the Reference.

9. Attached hereto as Exhibit H is a true and correct copy of Eric Larson, *Madoff Trustee Drops \$279 Million From Claim Against Merkin*, BLOOMBERG, Nov. 7, 2009, [http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aebYeET87\\_BQ](http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aebYeET87_BQ).

The foregoing is true to the best of my knowledge, information and belief.

Dated: August 31, 2012  
New York, New York

/s/ James C. McCarroll  
James C. McCarroll

# **EXHIBIT A**

**A-711**

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*Attorneys for Irving H. Picard, Esq., Trustee for the  
Substantively Consolidated SIPA Liquidation of  
Bernard L. Madoff Investment Securities LLC  
and the Estate of Bernard L. Madoff*

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

SECURITIES INVESTOR PROTECTION  
CORPORATION,

Plaintiff,

v.

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

In re:

BERNARD L. MADOFF,

Debtor.

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

Plaintiff,

v.

ERIC T. SCHNEIDERMAN, as successor to  
ANDREW M. CUOMO, Attorney General of the State  
of New York; BART M. SCHWARTZ, as Receiver  
for ARIEL FUND LTD. and GABRIEL CAPITAL,  
L.P.; DAVID PITOFISKY, as Receiver for ASCOT  
PARTNERS, L.P. and ASCOT FUND, LTD.; J.  
EZRA MERKIN; and GABRIEL CAPITAL  
CORPORATION,

Defendants.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

Adv. Pro. No. \_\_\_\_\_

**COMPLAINT**

### NATURE OF THE ACTION

1. On June 25, 2012, the New York State Attorney General (“NYAG”) announced a settlement with J. Ezra Merkin (“Merkin”) stemming from the Madoff fraud. The State of New York and two receivers appointed with the State’s approval (the “Receivers”) have thrust themselves into the aftermath of the Madoff fraud by seeking pecuniary relief, for select indirect investors, in a fraud that has grievously damaged victims throughout this country and around the world. They have done so in the face of a federally mandated program, the Securities Investor Protection Act (“SIPA”), tailored specifically to protect customers of failed brokerage houses on a *pro rata* basis. SIPA’s mandate is all the more compelling given the breadth of the losses in this horrendous Ponzi scheme. Every victim should be treated equally and that is the fundamental tenet of both SIPA and the Bankruptcy Code. That fundamental principle cannot be abrogated by the State of New York.

2. The Trustee commences this adversary proceeding to prevent certain parties, whose names appear in the caption above as defendants herein (the “Defendants”), including the NYAG, from undermining this Court’s continuing jurisdiction over the estate of BLMIS. By commencing actions (the “Third Party Actions”) and settling claims against Merkin and Gabriel Capital Corporation (“GCC,” together with Merkin, the “Merkin Defendants”), as well as Ascot Partners, L.P. and Ascot Fund, Ltd. (collectively, “Ascot Fund”), Ariel Fund Ltd. (“Ariel Fund”) and Gabriel Capital, L.P. (“Gabriel Fund,” collectively with Ascot Fund and Ariel Fund, the “Merkin Funds”), outside the purview of this Court, the Defendants threaten the orderly administration of the BLMIS estate and seek to diminish the pool of assets from which the Trustee can make equitable and *pro rata* distributions to the victims of Madoff’s fraud.

3. Consistent with this Court’s exclusive jurisdiction over the administration of the BLMIS estate, the Trustee seeks to ensure that estate property is recovered and distributed to the

victims of the Madoff Ponzi scheme in a fair and efficient manner consistent with SIPA and the United States Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.* (the “Bankruptcy Code”).

4. The Merkin Defendants were managers of the Merkin Funds, which invested in BLMIS. The Trustee has a pending adversary proceeding against the Merkin Defendants and the Merkin Funds in this Court, *Picard v. Merkin*, Adv. Pro. No. 09-1182 (Bankr. S.D.N.Y.) (the “Trustee’s Merkin Action”), seeking to recover more than \$500 million in estate property that was fraudulently transferred from BLMIS to the Merkin Defendants and the Merkin Funds.<sup>1</sup>

5. By commencing litigations and settling claims against the Merkin Defendants and the Merkin Funds, the Defendants have violated the automatic stay provisions of the Bankruptcy Code, section 78eee(b)(2)(B) of SIPA, and at least one of the related stay orders by the District Court for the Southern District of New York (the “District Court”) dated December 15, 2008, December 18, 2008, and February 9, 2009 (the “Stay Orders”).

6. On June 25, 2012, the NYAG announced a \$410 million settlement with the Merkin Defendants and the Merkin Funds (the “Settlement”). If the Settlement is permitted to proceed, the NYAG will be able to recover substantial assets held by the Merkin Defendants—including hundreds of millions of dollars of BLMIS customer property—which he will distribute to select investors in the Merkin Funds ahead of the BLMIS customers who are entitled to those funds. On information and belief, neither the Merkin Defendants nor all of the Merkin Funds will have sufficient assets to satisfy the Trustee’s more than \$500 million claim as a result of the Settlement.

7. Under the Agreement’s terms, as publicly announced, millions of dollars of estate property will not be distributed even to these select investors, but rather will be: (i) paid to the

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<sup>1</sup> The Trustee’s complaint did not specifically name Ascot Fund, Ltd.; however, Ascot Fund, Ltd. was subsumed in 2003 by Ascot Partners, L.P., and is thus a part of the Trustee’s Merkin Action.

NYAG to reimburse the costs of the litigation; and (ii) used to fund a complex claims determination and distribution process.

8. The Settlement and the Third Party Actions threaten the orderly administration of the BLMIS estate and seek to diminish the pool of assets sought by the Trustee, from which he must make equitable and *pro rata* distributions to the victims of Madoff's fraud.

9. The Settlement and the Third Party Actions, including the NYAG's action (the "NYAG Action"), violate the automatic stay and otherwise threaten the BLMIS estate. They seek to recover against certain of the same defendants named in the Trustee's Merkin Action for claims arising out of the BLMIS fraud and based on substantially the same operative facts as those alleged by the Trustee.

10. The Settlement (and the actions underlying it) seeks to recover the same property sought by the Trustee. Based on the information available to the Trustee, Ascot Fund was invested nearly entirely in BLMIS, so all of its assets consist of property of the estate, and a substantial portion of the assets held by the Merkin Defendants also consists of BLMIS funds. The Settlement, and the Third Party Actions underlying it, explicitly seek BLMIS customer funds that were transferred to the Merkin Defendants or the Merkin Funds, by seeking disgorgement or restitution of fees or profits from BLMIS, a constructive trust over all assets of the Merkin Defendants or, in the case of the NYAG, the recovery of substantial assets held by the Merkin Defendants.

11. In addition, it appears that the Merkin Defendants already have paid to settle at least three other actions, and at least two third party arbitrations have resulted in a confirmed arbitration award. To permit further recovery by the Defendants before resolution of the Trustee's Merkin Action would deprive the BLMIS estate of funds, prioritize investors in the

Merkin Funds over BLMIS customers, and subvert the statutory preference for customers mandated by SIPA. It would also reward a race to the courthouse and threaten the orderly administration of the BLMIS liquidation.

12. The Merkin Funds have all filed claims in the liquidation and are participating in the claims process in place before this Court.<sup>2</sup> In addition, the Settlement purports, among other things, to provide a recovery for the losses of investors in the Merkin Funds. By seeking to tap into the same pool of money as the Trustee before the conclusion of the Trustee's Merkin Action, the Third Party Actions threaten the administration of the BLMIS estate and the Defendants should be enjoined.

13. Accordingly, the Trustee respectfully requests that this Court enforce the automatic stay, section 78eee(b)(2)(B) of SIPA, and the Stay Orders and otherwise preliminarily enjoin the Defendants from diminishing, if not completely depleting, the Merkin Defendants' and the Merkin Funds' assets, which should be recovered and distributed by the Trustee.

#### **JURISDICTION AND VENUE**

14. This is an adversary proceeding brought in this Court, the Court in which the main underlying SIPA proceeding, Adv. Pro. No. 08-01789 (BRL) (substantively consolidated) is pending. The SIPA proceeding is a combined proceeding with the Securities and Exchange Commission (the "SEC") and was originally brought in the District Court as *Securities Exchange Commission v. Bernard L. Madoff Investment Securities LLC et al.*, No. 08 CV 10791 prior to its removal to this Court. This Court has jurisdiction over this adversary proceeding under 28 U.S.C. § 1334(b) and sections 78eee(b)(2)(A) and (b)(4) of SIPA.

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<sup>2</sup> While Ascot Fund, Ltd. did not file a claim, as noted above, this entity was subsumed in 2003 by Ascot Partners, L.P., which did file a claim in the liquidation.

15. An action for a declaratory judgment is properly commenced as an adversary proceeding pursuant to Rules 7001(2) and 7001(9) of the Federal Rules of Bankruptcy Procedure.

16. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O).

17. Venue in this district is proper under 28 U.S.C. § 1409.

18. This court has personal jurisdiction over the Defendants pursuant to Federal Rule of Bankruptcy Procedure 7004(f).

### **BACKGROUND, THE TRUSTEE AND STANDING**

19. The facts and procedural history relevant to the Madoff Ponzi scheme have been set forth numerous times and need not be repeated here.<sup>3</sup>

20. The Stay Orders were entered by the District Court shortly after the commencement of the liquidation. Specifically, in an order entered on December 15, 2008, the District Court declared that “all persons and entities are stayed, enjoined and restrained from directly or indirectly . . . interfering with any assets or property owned, controlled or in the possession of [BLMIS].” *SEC v. Bernard L. Madoff*, 08-CV-10791 (LLS), ECF No. 4 ¶ IV (reinforcing automatic stay); *see also* Order on Consent Imposing Preliminary Injunction Freezing Assets and Granting Other Relief Against Defendants, Dec. 18, 2008, ECF No. 8 ¶ IX (“no creditor or claimant against [BLMIS], or any person acting on behalf of such creditor or claimant, shall take any action to interfere with the control, possession or management of the assets subject to the receivership”); Partial Judgment on Consent Imposing Permanent Injunction

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<sup>3</sup> *See Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Bernard L. Madoff Inv. Sec. LLC)*, 424 B.R. 122, 125–33 (Bankr. S.D.N.Y. 2010), *aff’d* 654 F.3d 229 (2d Cir. 2011); *Picard v. Fox*, 429 B.R. 423, 426 (Bankr. S.D.N.Y. 2010) *aff’d* No. 10 Civ. 4652 (JGK), 2012 WL 990829 (S.D.N.Y. Mar. 26, 2012).

and Continuing Other Relief, Feb. 9, 2009, ECF No. 18 ¶ IV (incorporating and making the December 18, 2008 stay order permanent).

21. Appointed under SIPA, the Trustee is charged with recovering and distributing customer property to BLMIS's customers, assessing claims, and liquidating any other assets of the firm for the benefit of the estate and its creditors. Consistent with his duties, the Trustee is marshalling BLMIS's assets, and is well underway in that process.

22. The assets recovered, however, will not be sufficient to reimburse the customers of BLMIS for the billions of dollars that they invested with BLMIS over the years. Consequently, the Trustee must use his authority under SIPA and the Bankruptcy Code to pursue avoidable transfers and other recovery actions. Absent these recovery actions, the Trustee will be unable to satisfy the claims described in subparagraphs (A) through (D) of 15 U.S.C. § 78fff-2(c)(1).

23. Pursuant to section 78fff-1(a) of SIPA, the Trustee has the general powers of a bankruptcy trustee in a case under the Bankruptcy Code. Chapters 1, 3, 5 and subchapters I and II of chapter 7 of the Bankruptcy Code are applicable to this case, to the extent consistent with SIPA.

24. In addition to the powers of bankruptcy trustee, the Trustee has broader powers granted by SIPA pursuant to 15 U.S.C. §§ 78aaa *et seq.*

**THE COURT-ORDERED CLAIMS ADMINISTRATION PROCESS  
AND NET EQUITY DETERMINATIONS**

25. The Trustee sought and obtained an order from the Court to implement a customer claims process in accordance with SIPA.

26. Pursuant to an application of the Trustee dated December 21, 2008, the Court entered the Claims Procedures Order, which directed, among other things, that on or before

January 9, 2009: (a) a notice of the commencement of this SIPA Proceeding be published; (b) a notice of the liquidation proceeding and claims procedure be given to persons who appear to have been customers of BLMIS; and (c) notice of the liquidation proceeding and a claim form be mailed to all known general creditors of BLMIS.

27. More than 16,000 potential customer, general creditor, and broker-dealer claimants, including many of the Defendants, were included in the mailing of the notice.

28. Under the Claims Procedures Order, claimants were directed to mail their claims to the Trustee. All customers and creditors were notified of the mandatory statutory bar date for filing of claims under section 78fff-2(a)(3) of SIPA, which was July 2, 2009 (the "Bar Date"). The Trustee also provided several reminder notices.

29. By the Bar Date, the Trustee had received 16,239 customer claims.

30. In accordance with the Claims Procedures Order, the Trustee developed a comprehensive claims administration process for the intake, reconciliation, and resolution of the customer claims. The Trustee determined each customer's "net equity" by crediting the amount of cash deposited by the customer into her BLMIS account, less any amounts withdrawn from her BLMIS customer account, otherwise known as the "Net Investment Method." After certain claimants objected to the Trustee's interpretation of net equity, the Trustee moved for a briefing schedule and hearing on the matter.

31. On March 1, 2010, the Court issued its decision on the net equity issue, approving the Trustee's method of determining net equity. *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Bernard L. Madoff Inv. Sec. LLC)*, 424 B.R. 122 (Bankr. S.D.N.Y. 2010):

Because 'securities positions' are in fact nonexistent, the Trustee cannot discharge claims upon the false premise that customers' securities positions are what the account statements purport them to be. Rather, the only verifiable amounts that are manifest from the books and records are the cash deposits and withdrawals.

*Id.* at 135.

32. The Court also concluded that the Trustee’s calculation of net equity was consistent with the avoidance powers available to him under SIPA and the Bankruptcy Code, *id.* at 135–38, and that both equity and practicality favor utilizing the Trustee’s calculus:

Customer property consists of a limited amount of funds that are available for distribution. Any dollar paid to reimburse a fictitious profit is a dollar no longer available to pay claims for money actually invested. If the Last Statement Method were adopted, Net Winners would receive more favorable treatment by profiting from the principal investments of Net Losers, yielding an inequitable result.

\* \* \*

Equality is achieved in this case by employing the Trustee’s method, which looks solely to deposits and withdrawals that in reality occurred.

*Id.* at 141–42.

33. On March 8, 2010, the Court issued an order affirming the Trustee’s Net Equity calculation (“Net Equity Order”) and certified an appeal of the Net Equity Order directly to the United States Court of Appeals for the Second Circuit. (Net Equity Order, *Sec. Inv. Prot. Corp.*, Adv. Pro. No. 08-01789, ECF No. 2020; Certification of Net Equity Order, *Id.*, ECF No. 2022.)

34. On August 16, 2011, the Second Circuit affirmed the Net Equity Decision. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229 (2d Cir. 2011). The Second Circuit held that:

[I]f the Trustee had permitted the objecting claimants to recover based on their final account statements, this would have ‘affect[ed] the limited amount available for distribution from the customer property fund.’ [Citing *In re Bernard L. Madoff Sec., LLC*, 424 B.R. at 133.] The inequitable consequence of such a scheme would be that those who had already withdrawn cash deriving from imaginary profits in excess of their initial investment would derive additional benefit at the expense of those customers who had not withdrawn funds before the fraud was exposed.

*In re Bernard L. Madoff*, 654 F.3d at 238. On June 25, 2012, the United States Supreme Court denied *certiorari* review of the Second Circuit’s affirmance of the Net Equity Decision. *Velvel*

*v. Picard*, No. 11-986, \_\_\_ S. Ct. \_\_\_, 2012 WL 425188 (U.S. Jun. 25, 2012); *Ryan v. Picard*, No. 11-969, \_\_\_ S. Ct. \_\_\_, 2012 WL 396489 (U.S. Jun. 25, 2012).

**THE TRUSTEE'S ACTIONS AGAINST  
THE MERKIN DEFENDANTS AND THE MERKIN FUNDS**

35. The Trustee commenced his Merkin Action against the Merkin Defendants and the Merkin Funds on May 6, 2009 (Adv. Pro. No. 09-1182) in this Court. The Trustee seeks to avoid and recover more than \$500 million in avoidable transfers held by the Merkin Defendants and the Merkin Funds for equitable distribution to the victims of the Ponzi scheme. The Defendants represent potential beneficiaries of this recovery.

36. In his complaint (the "Trustee's Complaint"), the Trustee alleges that Merkin, a sophisticated investment manager with close business and social ties to Madoff, steered hundreds of millions of dollars from the Merkin Funds into BLMIS through his solely held corporation, GCC, and that the Merkin Funds and Merkin Defendants withdrew more than \$500 million from BLMIS from at least 1995 to 2008. The Merkin Defendants knew or should have known that BLMIS was predicated on fraud, as they were on notice of myriad indicia of fraud, but failed to diligently investigate. The Merkin Defendants received substantial fees and commissions from BLMIS in connection with their management of the Merkin Funds.

37. The Trustee's Complaint seeks the recovery from the Merkin Defendants and the Merkin Funds of BLMIS customer property under SIPA §§ 78fff(b), 78fff-1(a), and 78fff-2(c)(3), §§ 105(a), 502(d), 542, 544, 547, 548(a), 550(a) and 551 of the Bankruptcy Code, the New York Fraudulent Conveyance Act (N.Y. Debt & Cred. §§ 270 *et seq.*) and N.Y. C.P.L.R. 203(g). The Trustee also seeks the imposition of a constructive trust and disallowance of claims. On December 23, 2009, the Trustee amended his Complaint to add a new count seeking recovery from Merkin personally, based upon his position as general partner of Ascot Fund and Ascot

Fund's insolvency and inability to pay any judgments rendered against it, for all preferential and fraudulent transfers made from BLMIS to Ascot Fund. These transfers total in excess of \$500 million.

38. On January 25, 2010, the Merkin Defendants, Ariel Fund, and Gabriel Fund renewed Motions to Dismiss the Trustee's Amended Complaint. On November 17, 2010, this Court entered a Decision and Order denying the Motions to Dismiss as to all Counts, with the exception of claims for immediate turnover under section 542 and preferential transfers.<sup>4</sup> The Court held that the Trustee alleged viable claims for actual fraudulent transfers, constructive fraudulent transfers, undiscovered fraudulent transfers, subsequent transfers to the Merkin Defendants, and general partner liability of Merkin, specifically holding that voidable transfers received by Ascot Fund could be recovered from Merkin as Ascot Fund's sole general partner. Bart M. Schwartz ("Schwartz"), as receiver for Ariel Fund and Gabriel Fund, filed a Motion for Leave to Appeal with the District Court. That motion was denied on August 31, 2011.

#### THE SETTLEMENT AND THIRD PARTY ACTIONS

39. The NYAG Settlement relates to at least two actions, one brought by the NYAG, and one brought by Schwartz, as receiver for Ariel Fund and Gabriel Fund.<sup>5</sup> The Settlement appears to have a process in place to resolve other pending litigation as well.

- (1) ***Eric T. Schneiderman, as successor to Andrew M. Cuomo, Attorney General of the State of New York v. J. Ezra Merkin, et al., Index No. 450879/2009 (N.Y. Sup. Ct.) (J. Lowe)***

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<sup>4</sup> There were no preferential transfers made to Ariel Fund and Gabriel Fund. The only preferential transfers at issue were made to Ascot Fund.

<sup>5</sup> David Pitofsky, as receiver for Ascot Fund, is participating in the Settlement. Ascot Fund began investing with BLMIS sometime before 1995 and was nearly entirely invested with BLMIS.

40. On or about April 6, 2009, the NYAG commenced the NYAG Action against the Merkin Defendants on behalf of investors in the Merkin Funds in the Supreme Court of the State of New York, County of New York. The NYAG Action is pending before Judge Richard Lowe.

41. The NYAG seeks restitution and compensatory damages on behalf of the Merkin Funds' investors, attorneys' fees, and other expenses. The NYAG also seeks an accounting and an injunction prohibiting the Merkin Defendants from engaging in the securities business in the State of New York, which is not the subject of the instant application.

42. The stated purposes of the NYAG Action is to promote the "economic health and well-being of investors" and "financial well-being" of non-profit organizations and to seek restitution for the Merkin Defendants' fraudulent conduct.

43. The NYAG Complaint does not specify the dollar amount sought by the NYAG beyond seeking "all restitution and damages" caused by the complained-of acts. However, prior to the Settlement, the NYAG asserted that he sought to recover nearly \$729 million in fees from the Merkin Defendants, in addition to damages sought for fictitious profits, attorneys' fees or other expenses.

44. The NYAG thus seeks the funds that allegedly were transferred by BLMIS to the Merkin Funds and Merkin Defendants—the same funds that the Trustee seeks to recover in his litigation for the benefit of all BLMIS customers and creditors. The recovery of these amounts by the NYAG would significantly reduce the Merkin Defendants' assets, and possibly exhaust available liquid assets, rendering any victory by the Trustee in his litigation pyrrhic.

45. Just as the Trustee sets forth in his Complaint, the NYAG alleges that Merkin knew or should have known of the Ponzi scheme and that he failed to conduct proper due diligence over BLMIS.

46. Notably, the NYAG alleges that “Merkin collected hundreds of millions of dollars in fees for managing investors’ funds, while turning all, or a substantial portion, of those funds over to Madoff and others . . . whom Merkin failed to adequately oversee, audit, or investigate.” The Trustee has alleged in his Merkin Action that the fees paid to the Merkin Defendants in connection with the Merkin Funds’ BLMIS investments were withdrawn from BLMIS. Thus, the NYAG seeks the same hundreds of millions of dollars that were fraudulently transferred by BLMIS to Merkin that are sought by the Trustee.

47. On October 18, 2010, the NYAG filed a motion for summary judgment, which was *sub judice* until the time of the Settlement and has been marked off calendar in light of the Settlement.

48. Various “freeze orders” (the “Freeze Orders”) were entered in the NYAG Action to preserve assets for the NYAG to recover.

49. These Freeze Orders have not been enough to prevent the dissipation of Merkin’s assets to date, as the NYAG apparently agreed to allow Merkin to pay out assets of three other actions, and at least two third party arbitrations have resulted in confirmed arbitration awards, while the Freeze Orders were supposedly in effect.<sup>6</sup>

50. More importantly, they provide no protection against recovery by the NYAG, which has now settled with the Merkin Defendants.

**(2) *Bart M. Schwartz, as Receiver for Ariel Fund Ltd. and for Gabriel Capital, L.P. v. J. Ezra Merkin, et al., Index No. 651516/2010 (N.Y. Sup. Ct.) (J. Lowe)***

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<sup>6</sup> The Trustee is considering whether to expend additional resources to pursue the third party plaintiffs in these actions as subsequent transferees: (1) *Congregation Machsikai Torah-Beth Pinchas v. Ascot Partners, L.P., et al.*, Index No. 09-02118 (Mass. Sup. Ct.); (2) *Sandalwood Debt Fund A, L.P., and Sandalwood Debt Fund B, L.P. v. J. Ezra Merkin*, Index No. 651441/2010 (N.Y. Sup. Ct.); and (3) *The Calibre Fund, LLC v. J. Ezra Merkin, et al.*, Index No. 107978/2011 (N.Y. Sup. Ct.).

51. Bart Schwartz, as Receiver for Ariel and Gabriel Funds, is participating in the Settlement. The Receiver's litigation, just like the NYAG's litigation, seeks fraudulently transferred customer property.

52. On or about September 16, 2010, Ariel Fund and Gabriel Fund, through their court-appointed receiver, Bart Schwartz, commenced an action against the Merkin Defendants in the Supreme Court of the State of New York, County of New York (the "Schwartz Action") by filing a complaint (the "Schwartz Complaint").

53. Through the Schwartz Action, Ariel Fund and Gabriel Fund seek unspecified compensatory, consequential and punitive damages, as well as attorneys' fees and other expenses and interest. They also seek "a constructive trust over *all assets, property, and/or cash currently in the custody and control of each Defendant*" including, among other things, "all assets or compensation received by the Defendants in connection with the business of the Funds."

54. The Schwartz Complaint therefore seeks control over the same \$500 million in fraudulently transferred BLMIS customer property that the Trustee seeks in his Merkin Action. On December 17, 2010, the Merkin Defendants filed a motion to dismiss the Schwartz Action. That motion was pending at the time the Settlement was announced, and has been marked off calendar in light of the Settlement.

55. Akin to the Trustee's Complaint, the Schwartz Complaint alleges that the Merkin Defendants benefited from investing with BLMIS, even though they knew or should have known that they were benefiting from a fraud. The harm claimed by Ariel Fund and Gabriel Fund stems fundamentally from the BLMIS fraud.

56. More significantly, by seeking a constructive trust over all assets held by the Merkin Defendants, the Funds seek to recover for themselves the same fraudulent transfers

sought by the Trustee. Schwartz has readily acknowledged that the Trustee's Merkin Action is "already pending," "relatively well developed," and "will be better adjudicated" before this Court.

(3) *The Settlement*

57. As announced in Attorney General Schneiderman's Press Release, the NYAG "secured a \$410 million settlement with J. Ezra Merkin," recovering the Merkin Defendants' management fees in connection with the Merkin Funds. The Settlement seeks to compensate select investors in these funds, paying "\$405 million to compensate investors over a three-year period, and \$5 million to the State of New York to cover fees and costs."

58. The Settlement consists of a complex, and no doubt costly, system, whereby David Pitofsky and Bart Schwartz, court-appointed receivers for the Merkin Funds, will direct payments to select investors depending on a determination of whether they were aware of Merkin's delegation of authority to Madoff: "Depending on the size of their losses, eligible investors will be entitled to receive over 40 percent of their cash losses. Pursuant to a claims process, investors who were not aware of Merkin's delegation to Madoff will receive a defined percentage of their losses, while those who were aware of Madoff's role will be eligible to receive a smaller recovery."

59. The New York State court is to retain continuing jurisdiction over the Settlement. The NYAG further stated that the select investors who would benefit from the Settlement "are likely to receive additional payments at a future date when the Madoff Estate is able to distribute moneys recovered by Irving Picard."

60. Thus, through the Settlement, the NYAG seeks to: (1) obtain a substantial portion of Merkin's assets; (2) for fraudulently transferred assets consisting of "other people's money;" (3) for distribution to select investors; (3) to the detriment of all other BLMIS customers; and (4)

outside the jurisdiction of this Court. The Settlement is nothing less than an out and out assault on this Court's jurisdiction over the BLMIS estate and the equitable distribution scheme put into place by this Court and affirmed by the Second Circuit.

61. The Trustee attempted to obtain a copy of the Settlement Agreement. Over nearly a one month period, the Trustee engaged in good-faith negotiations with counsel for various Defendants in an effort to see the precise terms of the Settlement. Despite agreeing to the material terms of a confidentiality agreement no later than July 11, 2012 in order to obtain the Settlement Agreement, the Trustee was informed by counsel for the NYAG on July 26, 2012 that the NYAG would not provide the Settlement Agreement to the Trustee, deeming it "premature" to do so.

**THE AUTOMATIC STAY, STAY ORDERS, AND SIPA SECTION  
78eee(b)(2)(B) SHOULD BE ENFORCED AND THIS  
COURT SHOULD ISSUE A PRELIMINARY INJUNCTION**

62. The Defendants' claims are inextricably linked and related to the underlying SIPA proceeding and the Trustee's Merkin Action. The Settlement will impair this Court's jurisdiction over property of the estate and the Trustee's ability to marshal such customer property on behalf of the estate.

63. The Third Party Actions violate at least the December 15, 2008 Stay Order issued by the District Court, if not all of the Stay Orders.

64. The Settlement (and the actions underlying it) threaten to allow certain indirect investors of BLMIS to recover more than their fair share of the BLMIS estate by depleting the assets of the Merkin Defendants and the Merkin Funds. Such an outcome will compromise the equitable distribution of customer property through the estate.

65. The Settlement threatens to frustrate the goals of SIPA, which seeks to return to each customer, on an equitable basis, his or her net equity in the debtor. The Settlement, as well as the continued prosecution of the Third Party Actions, would also allow the Defendants to circumvent the claims process established by the Court, undermining this Court's jurisdiction and interfering with the administration of the liquidation.

66. The Settlement seeks to recover the same funds sought by the Trustee, and concerns the same fraudulent transfers received from BLMIS. Indeed, the Settlement purports to recover fees paid to the Merkin Defendants. As the Trustee has alleged, these fees and commissions were paid to the Merkin Defendants through transfers from BLMIS and are some of the same transfers sought by the Trustee.

67. The only money held by Ascot Fund is money that was wrongfully transferred as part of Madoff's Ponzi scheme, which means that any "damages" recovered from Ascot Fund will necessarily consist of estate property.

68. The transfers that the Merkin Defendants and the Merkin Funds received in connection with BLMIS included more than \$500 million of customer funds. Specifically, based on the Trustee's investigation to date, the Trustee does not believe that the Merkin Defendants can satisfy both the amount purportedly due under the Settlement and the over \$500 million the Trustee seeks in his litigation. Thus, the Settlement would deplete the pool of fraudulently transferred property available for recovery by the estate.

**COUNT ONE  
DECLARATORY RELIEF**

69. The Trustee incorporates by reference the allegations contained in the foregoing paragraphs of this Complaint as if fully realleged herein.

70. This is a claim for declaratory relief under 28 U.S.C. §§ 2201, *et seq.*

71. The Trustee seeks a declaration that the Settlement and the Third Party Actions violate at least one of the Stay Orders and the automatic stay provisions under 11 U.S.C. § 362(a) and 15 U.S.C. § 78eee(b)(2)(B). This declaratory relief is warranted for, without limitation, the following reasons:

(a) By seeking to recover from the Merkin Defendants and the Merkin Funds, the Settlement and the Third Party Actions improperly contravene the claims administration process in the SIPA proceeding and sidestep the Trustee's exclusive right to seek recovery of fraudulently transferred property in violation of 11 U.S.C. § 362(a)(1) and (6).

(b) Additionally, the Settlement and Third Party Actions improperly seek to recover on a claim against the estate of BLMIS and/or Madoff in violation of 11 U.S.C. § 362(a)(1) and seek to obtain possession of estate property in direct violation of 11 U.S.C. § 362(a)(3), 15 U.S.C. § 78eee(b)(2)(B) and the Stay Orders.

72. This Court has authority pursuant to sections 105(a) and 362(a) of the Bankruptcy Code to issue declaratory relief because this controversy is actual and justiciable, and the Court has jurisdiction over matters affecting property of the estate and the effective and equitable administration of the estate of BLMIS and/or Madoff.

**COUNT TWO  
PRELIMINARY INJUNCTION**

73. The Trustee incorporates by reference the allegations contained in the foregoing paragraphs of this Complaint as if fully realleged herein.

74. The Trustee seeks injunctive relief by way of an order that any actions towards effectuating the terms of the Settlement, any further prosecution of the Third Party Actions, and any distribution of assets by the Merkin Defendants or Merkin Funds in connection with the Settlement and the Third Party Actions or any other actions brought against the Merkin

Defendants or Merkin Funds as a result of the BLMIS fraud, should be enjoined pursuant to section 105(a) of the Bankruptcy Code, made applicable to these proceedings by section 78fff(b) of SIPA. Specifically, the Trustee requests that this Court enjoin the Defendants from effectuating the Settlement (or prosecuting the Third Party Actions) except to the extent that the NYAG Action seeks injunctive relief and an accounting, for, without limitation, the following reasons:

(c) The Settlement and Third Party Actions improperly infringe on the jurisdiction of this Court. Any funds recovered in the Settlement or the Third Party Actions have a strong likelihood of consisting of estate property, recoverable by the Trustee. As such, further effectuation of the Settlement or prosecution of the Third Party Actions could ultimately result in another court determining how potential customer property is distributed among certain BLMIS customers and creditors.

(d) To the extent that Defendants successfully effectuate the Settlement or prevail in the Third Party Actions, section 78fff-2(c)(1)—which provides for the ratable distribution of customer property to customers—would be violated because investors in the Merkin Funds would receive more than their proportionate share of customer property to the detriment of BLMIS customers with allowed claims.

(e) The claims asserted in the Third Party Actions are so inextricably intertwined and related to the underlying SIPA proceeding and the Trustee's Merkin Action that continued efforts to fulfill the terms of the Settlement or prosecute the Third Party Actions will impair this Court's jurisdiction over this proceeding and the Trustee's ability to marshal assets on behalf of the estate.

(f) There is an inadequate remedy at law to protect and preserve the assets that constitute customer property. The Settlement and Third Party Actions threaten the administration of the liquidation, and an injunction is necessary to preserve and protect estate property and the Trustee's efforts to gather and collect estate property for the benefit of the victims who have filed claims.

(g) An injunction will prevent the substantial confusion of other investors and potential plaintiffs with respect to whether they must file separate actions to protect their interests, or participate in the Settlement, and the Settlement's separate claims administration process.

(h) An injunction will avoid the possibility of inconsistent decisions and will ensure preservation of uniformity of decision.

(i) The injunction will not harm the public interest, and, in fact, is in the best interests of BLMIS customers and will allow for the orderly administration of the claims administration process.

75. The injunction requested herein is necessary and appropriate to carry out the Trustee's duties in accordance with the provisions of SIPA and the Bankruptcy Code. The Settlement and further prosecution of the Third Party Actions would seriously impair and potentially defeat this Court's jurisdiction and the Court's ability to administer the BLMIS proceedings.

76. The Trustee also seeks to preliminarily enjoin the Defendants and their officers, agents, servants, employees, attorneys, assigns and those acting in concert or participation with them, from executing any judgments, making or receiving any settlement payments, or otherwise distributing assets in connection with the Settlement or the Third Party Actions or any other

actions brought against the Merkin Defendants and/or the Merkin Funds as a result of the BLMIS fraud, until the completion of the Trustee's Merkin Action, including the satisfaction by the Merkin Defendants and/or the Merkin Funds of any settlement or judgment obtained by the Trustee.

**WHEREFORE**, the Trustee respectfully requests that this Court enter judgment in favor of the Trustee and against the Defendants:

*i.* declaring that the Third Party Actions are void *ab initio* as against the Merkin Defendants and the Merkin Funds (except to the extent the NYAG's Action seeks injunctive relief and an accounting), as violative of the automatic stay provisions of Bankruptcy Code § 362(a), SIPA § 78eee(b)(2)(B)(i), and at least one of the Stay Orders, and that the Settlement is thus void;

*ii.* preliminarily enjoining, pursuant to section 105(a) of the Bankruptcy Code, the Defendants, their officers, agents, servants, employees, attorneys, and all those acting in concert or participation with them, or acting on their behalf, from consummating the Settlement, including transferring any money or property in connection with the Settlement, executing any judgments, making or receiving any settlement payments, or otherwise distributing assets in connection with the Settlement or the Third Party Actions or any other actions brought against the Merkin Defendants and/or the Merkin Funds as a result of the BLMIS fraud; and litigating the Third Party Actions or any other actions as against any of the Merkin Defendants and/or the Merkin Funds brought as a result of the BLMIS fraud, until the completion of the Trustee's Merkin Action, including the satisfaction by the Merkin Defendants and/or the Merkin Funds of any settlement or judgment obtained by the Trustee;

*iii.* granting the Trustee such other relief as the Court deems just and proper.

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Date: New York, New York  
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# **EXHIBIT B**

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Substantively Consolidated SIPA Liquidation of  
Bernard L. Madoff Investment Securities LLC  
and the Estate of Bernard L. Madoff*

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

SECURITIES INVESTOR PROTECTION  
CORPORATION,

Plaintiff,

v.

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

In re:

BERNARD L. MADOFF,

Debtor.

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

Plaintiff,

v.

ERIC T. SCHNEIDERMAN, as successor to  
ANDREW M. CUOMO, Attorney General of the  
State of New York; BART M. SCHWARTZ, as  
Receiver for ARIEL FUND LTD. and GABRIEL  
CAPITAL, L.P.; DAVID PITOFISKY, as  
Receiver for ASCOT PARTNERS, L.P. and  
ASCOT FUND, LTD.; J. EZRA MERKIN; and  
GABRIEL CAPITAL CORPORATION,

Defendants.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

Adv. Pro. No. \_\_\_\_\_

**MEMORANDUM OF LAW IN  
SUPPORT OF TRUSTEE'S  
APPLICATION FOR ENFORCEMENT  
OF AUTOMATIC STAY AND ISSUANCE  
OF PRELIMINARY INJUNCTION**

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**MEMORANDUM OF LAW IN SUPPORT OF TRUSTEE'S  
APPLICATION FOR ENFORCEMENT OF AUTOMATIC STAY AND  
RELATED STAY ORDERS AND ISSUANCE OF PRELIMINARY INJUNCTION**

Irving H. Picard, as trustee (the "Trustee") for the substantively consolidated liquidation of the estate 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 ("Madoff"), by and through his undersigned counsel, respectfully submits this memorandum of law in support of his application ("Application") pursuant to sections 362(a) and 105(a) of the United States Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.* (the "Bankruptcy Code") and SIPA §§ 78eee(a)(3) and 78eee(b)(2)(A) and (B) for Enforcement of the Automatic Stay, Related Stay Orders and Preliminary Injunction against the defendants named in the above-referenced caption (the "Defendants").

**PRELIMINARY STATEMENT**

The Trustee brings the within motion with full awareness of the unusual, if not extraordinary, nature of the relief sought here. The State of New York and two receivers appointed with the State's approval have thrust themselves into the aftermath of the Madoff fraud by seeking pecuniary relief, for a select subgroup of indirect investors, in a fraud that has grievously damaged victims throughout this country and around the world. They have done so in the face of a federally mandated program, SIPA, tailored specifically to protect customers of failed brokerage houses on a *pro rata* basis. SIPA's mandate is all the more compelling given the breadth of the losses in this horrendous Ponzi scheme. So while the New York Attorney General ("NYAG") may seek to characterize the Trustee's application as an attempt to thwart the efforts of the State to remit some of the funds lost by New York State residents in the Madoff debacle, in reality, the Trustee's purpose is to enforce the federal mandate of SIPA and salutary goals of SIPA and the Bankruptcy Code. Every victim should be treated equally and that is the

fundamental tenet of both SIPA and the Bankruptcy Code. That fundamental principle cannot be abrogated by the State of New York. Put simply, the State of New York should not be permitted to wreak havoc on that long standing federal mandate by using New York State law to give its citizens and perhaps others in a select group a jump start over all of the victims of this heinous fraud. The police power exemption from the automatic stay was not designed to allow the State government to seek to satisfy the pecuniary interests of a specific group affected by the fraud. Such a use of State power in this setting is inappropriate, unfair and a violation of principles of equity governing the protection that must be afforded to all of Madoff's victims, not just those served by the State of New York. As the NYAG well knows, the Trustee is in litigation with J. Ezra Merkin ("Merkin") and related entities before this Court, and seeks, among other things, the same funds fraudulently received by Merkin and his funds that the NYAG purports to reach in his settlement (the "Settlement"). As alleged by the Trustee, those funds are fraudulent transfers and constitute estate property that should be available to all of those who lost their money to Madoff.

Moreover, the NYAG has kept the precise terms of this Settlement secret. The settlement agreement ("Settlement Agreement") has not been made public and the NYAG will not provide the Trustee with a copy of that Agreement, despite putting the Trustee through the paces of negotiating a confidentiality agreement in order to obtain the Settlement Agreement. (*See* Declaration of Marc D. Powers in Support of Enforcement of the Automatic Stay, Related Stay Orders and Issuance of Preliminary Injunction, dated August 31, 2012 (the "Powers Decl.") ¶ 9.) The Trustee does not know whether any transfers of Merkin's assets already have occurred, or when the Settlement will close. The NYAG's desire to keep the Settlement Agreement private is little wonder. The terms that were released publicly cast doubt on the fairness of the Settlement.

The beneficiaries are not BLMIS customers, but indirect investors, who, under the Settlement, take in excess of \$400 million that does not belong to those indirect investors, but rather belongs to BLMIS customers. Merkin's money is not limitless, and with the prospect of over \$400 million depleted through the Settlement, the Trustee is concerned that little or nothing will be left for BLMIS customers. It is this Court that should decide how to distribute money to the victims of Madoff's fraud. If other attorneys general around the country could simply walk into state courts and secure settlements as the NYAG did, the BLMIS estate would be decimated, with residents of various states favored. Even if the NYAG's actions were exempt from the automatic stay (which they are not), there is no exemption for the NYAG's enforcement of the Settlement, which is effectively a money judgment affecting the estate. The Trustee seeks to put the Settlement squarely before this Court, where it belongs.

Merkin and Gabriel Capital Corporation ("GCC," and together with Merkin, the "Merkin Defendants") were managers of several funds that invested in BLMIS, including Ascot Partners, L.P. and Ascot Fund, Ltd. (collectively, "Ascot Fund"), Ariel Fund Ltd. ("Ariel Fund"), and Gabriel Capital, L.P. ("Gabriel Fund," collectively with Ascot Fund and Ariel Fund, the "Merkin Funds"). The Trustee commenced a lawsuit pending in this Court against the Merkin Defendants and the Merkin Funds seeking to recover more than \$500 million in estate property that was fraudulently transferred from BLMIS to the Merkin Defendants and Merkin Funds ("Trustee's Merkin Action").<sup>1</sup> Numerous other lawsuits and arbitrations have been brought against certain of these Merkin entities stemming from these investments, including actions by the NYAG (the "NYAG Action") and Bart Schwartz ("Schwartz"), court-appointed receiver for Ariel Fund and Gabriel Fund (the "Schwartz Action," together with the NYAG Action, the "Third Party

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<sup>1</sup> The Trustee's complaint did not specifically name Ascot Fund, Ltd.; however, Ascot Fund, Ltd. was subsumed by Ascot Partners, L.P. in 2003 and is thus a part of the Trustee's Merkin Action.

Actions”).<sup>2</sup> On June 25, 2012, the NYAG announced that he reached the Settlement with Merkin.

According to the NYAG’s June 25, 2012 press release (the “NYAG Press Release”), the NYAG “secured a \$410 million settlement with J. Ezra Merkin,” recovering Merkin’s management fees in connection with the Merkin Funds. (*See* Powers Decl. Ex. A.) The Settlement purportedly seeks to compensate select investors in these funds, paying “\$405 million to compensate investors over a three-year period, and \$5 million to the State of New York to cover fees and costs.” (*See id.*) According to the NYAG Press Release, the Settlement consists of a complex (and no doubt costly) system, whereby David Pitofsky and Schwartz, court-appointed receivers for the Merkin Funds (the “Receivers”), will direct the payments to select investors depending on a determination of whether they were aware of Merkin’s delegation of authority to Madoff: “Depending on the size of their losses, eligible investors will be entitled to receive over 40 percent of their cash losses. Pursuant to a claims process, investors who were not aware of Merkin’s delegation to Madoff will receive a defined percentage of their losses, while those who were aware of Madoff’s role will be eligible to receive a smaller recovery.” (*See id.*)

As stated in the NYAG Press Release, the Settlement and its contemplated claims process will not be governed by this Court or subject to this Court’s jurisdiction, but is instead subject to the jurisdiction of the New York State Supreme Court. (*See id.*) However, as the Trustee has alleged in his Merkin Action, the fees received by Merkin were fraudulent transfers received, directly or indirectly, from BLMIS and, as such, belong to the BLMIS estate and are the subject of this Court’s exclusive jurisdiction under SIPA § 78eee(b)(2)(A). The NYAG further stated

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<sup>2</sup> The Trustee reserves the right to seek to enforce the automatic stay and related stay orders and seek injunctive relief with respect to other competing third party actions against the Merkin Defendants and/or the Merkin Funds.

that the select investors who would benefit from the Settlement “are likely to receive additional payments at a future date when the Madoff Estate is able to distribute moneys recovered by Irving Picard.” (See Powers Decl. Ex. A.) The distribution to select investors directly contravenes the equitable distribution system put into place by this Court pursuant to SIPA and affirmed by the Second Circuit, as well as the claims administration process. The contemplated overlay of a duplicative claims process administered outside this Court’s supervision is an affront to this Court’s jurisdiction.

The Trustee and his counsel are concerned that the Merkin Defendants and the Merkin Funds will imminently dissipate their assets by making payments pursuant to the Settlement. This concern is exacerbated by the fact that the Trustee does not believe that the Merkin Defendants and also, in particular, Ascot Fund, can satisfy both the amount purportedly due under the Settlement and the over \$500 million the Trustee seeks in his litigation. (Powers Decl. ¶ 8.) The risk of dissipation is heightened by the Trustee’s belief that nearly \$200 million of the Merkin Defendants’ assets is currently held in escrow by BNY Mellon N.A., as escrow agent, pending resolution of the NYAG Action.<sup>3</sup> (*Id.*) It is unclear what reachable assets of the Merkin Defendants may be left, but it is clear that the remaining assets of the Merkin Defendants will be insufficient to satisfy the Trustee’s claims. Such an outcome would be extraordinarily prejudicial to the creditors of the BLMIS estate.

Three different judges in the United States District Court for the Southern District of New York (the “District Court”) have affirmed decisions by this Court holding that conduct similar to that alleged here—in which fraudulent transfers are being sought by third parties outside the

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<sup>3</sup> Further to this point, a pending summary judgment motion in the NYAG Action before Justice Lowe, as well as a pending motion to dismiss in the Schwartz Action, were both recently “marked off due to pending settlement,” according to the state court’s docket. (See Powers Decl. Exs. E, M.)

auspices of the bankruptcy court—violates the automatic stay and is properly enjoined under sections 362 and 105(a). See *In re Bernard L. Madoff Inv. Sec. LLC*, No. 11-2135 (AKH), 2011 WL 7981599 (S.D.N.Y. Dec. 5, 2011) (Hellerstein, J.) (“*Stahl* Summary Order”); *Picard v. Fox*, No. 10-4652 (JGK), 2012 WL 990829 (S.D.N.Y. Mar. 26, 2012) (Koeltl, J.); *Picard v. Maxam Absolute Return Fund, L.P.*, No. 08-1789 (BRL), 2012 WL 1570859 (S.D.N.Y. May 4, 2012) (Oetken, J.). The same result is warranted here.

Even if the Settlement were not in and of itself violative of the automatic stay, the stay provisions of SIPA, and the related Stay Orders, and inextricably intertwined with the Trustee’s claims (which it is), it seeks to recover from the same limited pool of funds sought by the Trustee. As the District Court recognized in *Stahl*, “rather than have a profusion of claims, it’s the rationale behind Section 362 and Section 105 to favor the trustee. It doesn’t have to be for all time, but it has to allow the trustee the ability to pursue his actions and obtain rulings and finality on those rulings because the trustee is acting for the benefit of all creditors and not just a few.” *In re Bernard L. Madoff Inv. Sec. LLC*, No. 11-2392, 2011 WL 7975167, at \*13 (S.D.N.Y. Nov. 17, 2011) (Hellerstein, J.) (“*Stahl* Ruling”). To permit the NYAG to settle its claims, in contravention of this Court’s jurisdiction, would reward a race to the courthouse by allowing certain indirect investors to recover BLMIS customer funds, the same funds that the Trustee is seeking to recover for equitable distribution.

Accordingly, the Trustee respectfully requests that this Court enforce the automatic stay and related Stay Orders and preliminarily enjoin the Defendants from diminishing, if not completely depleting, the Merkin Defendants’ and Merkin Funds’ assets, which should be recovered and equitably distributed by the Trustee.<sup>4</sup>

<sup>4</sup> At a hearing held on July 18, 2012, this Court addressed a similar request for relief by the Trustee in the context of the Stanley Chais litigation. The Court and the parties agreed to mediation to address the complex issues there, and

**RELIEF REQUESTED**

The Trustee respectfully requests that this Court: (i) enforce the automatic stay of the Bankruptcy Code, SIPA §§ 78eee(b)(2)(A) and (B), and the related orders of the United States District Court for the Southern District of New York, entered pursuant to the Securities Investor Protection Corporation’s (“SIPC”) Application, and dated December 15, 2008, December 18, 2008, and February 9, 2009, (the “Stay Orders”); (ii) declare that the Third Party Actions are void *ab initio* as against the Merkin Defendants and Merkin Funds (except to the extent the NYAG Action seeks injunctive relief and an accounting) and that the Settlement is thus void; (iii) preliminarily enjoin the Defendants from consummating the Settlement, including transferring any money or property in connection with the Settlement, executing any judgments, making or receiving any settlement payments, or otherwise distributing assets in connection with the Settlement or the Third Party Actions or any other actions brought against the Merkin Defendants and/or the Merkin Funds as a result of the BLMIS fraud; and litigating the Third Party Actions or any other actions as against any of the Merkin Defendants and/or the Merkin Funds brought as a result of the BLMIS fraud, until the completion of the Trustee’s Merkin Action, including the satisfaction by the Merkin Defendants and/or the Merkin Funds of any settlement or judgment obtained by the Trustee; and (iv) compel the Defendants to produce the Settlement Agreement to this Court, the Trustee, and SIPC.

**STATEMENT OF FACTS**

The facts and procedural history relevant to the Madoff Ponzi scheme have been set forth numerous times and need not be repeated here. *See Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Bernard L. Madoff Inv. Sec. LLC)*, 424 B.R. 122, 125–33 (Bankr. S.D.N.Y.

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the Court may determine that the same result is warranted here given the complexity of the issues. (*See Order Directing Mediation, Picard v. Hall et al.*, Adv. Pro. No. 12-1001, ECF No. 34 (July 18, 2012).)

2010); *Picard v. Fox*, 429 B.R. 423, 426–28 (Bankr. S.D.N.Y. 2010). What follows is a brief summary of the pertinent background facts.

#### A. The Stay Orders

The Stay Orders were entered by the District Court shortly after the commencement of the liquidation. Specifically, in an order entered on December 15, 2008, the District Court, on SIPC’s Application pursuant to § 78eee(b)(2)(B), declared that “all persons and entities are stayed, enjoined and restrained from directly or indirectly . . . interfering with any assets or property owned, controlled or in the possession of [BLMIS].” *SEC v. Bernard L. Madoff*, 08-CV-10791 (LLS), ¶ IV (reinforcing automatic stay); *see also* Order on Consent Imposing Preliminary Injunction Freezing Assets and Granting Other Relief Against Defendants, Dec. 18, 2008, ECF No. 8, ¶ IX (“[N]o creditor or claimant against [BLMIS], or any person acting on behalf of such creditor or claimant, shall take any action to interfere with the control, possession or management of the assets subject to the receivership.”); Partial Judgment on Consent Imposing Permanent Injunction and Continuing Other Relief, Feb. 9, 2009, ECF No. 18, ¶ IV (incorporating and making the December 18, 2008 stay order permanent).

#### B. The Court-Ordered Claims Administration Process<sup>5</sup>

The Trustee sought and obtained approval from this Court to implement a customer claims process in accordance with SIPA (the “Claims Procedure Order”), which required, *inter alia*, that certain notices be given.<sup>6</sup> More than 16,000 potential customer, general creditor, and

<sup>5</sup> The facts in this section are drawn from the Trustee’s Third Interim Report. (Trustee’s Amended Third Interim Report, *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, Adv. Pro. No. 08-01789, ECF No. 2207.)

<sup>6</sup> Pursuant to an application of the Trustee dated December 21, 2008 (Adv. Pro. No. 08-01789, ECF No. 8), this Court entered the Claims Procedure Order (*id.*, ECF No. 12), which directed, among other things, that on or before January 9, 2009: (a) a notice of the commencement of this SIPA proceeding be published; (b) notice of the liquidation proceeding and claims procedure be given to persons who appear to have been customers of BLMIS; and (c) notice of the liquidation proceeding and a claim form be mailed to all known general creditors of the debtors.

broker-dealer claimants, including the Merkin Funds, were included in the mailing of the notice. The Trustee published the notice in all editions of *The New York Times*, *The Wall Street Journal*, *The Financial Times*, *USA Today*, *Jerusalem Post*, and *Ye-diot Achronot* and posted claim forms and claims filing instructions on the Trustee's website ("Trustee Website"), and the website of SIPC.

Under the Claims Procedure Order, claimants were directed to mail their claims to the Trustee. All customers and creditors were notified of the mandatory statutory bar date for the filing of claims under section 78fff-2(a)(3) of SIPA, which was July 2, 2009 (the "Bar Date"). The Trustee also provided several reminder notices. By the Bar Date, the Trustee had received 16,239 customer claims.

On June 28, 2011, the Court held that indirect investors in BLMIS, who had invested in investment funds, such as the Merkin Funds, were not "customers" of BLMIS entitled to SIPA protection. *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff)*, 454 B.R. 285 (Bankr. S.D.N.Y. 2011) (the "Customers Decision"). The Court recognized that SIPA § 78lll(2) limits the definition of "customers" to parties directly holding an investment account with BLMIS. *Id.* at 294–95. The District Court affirmed this Court's decision, *see In re Aozora Bank Ltd.*, 2012 WL 28468 (S.D.N.Y. Jan. 4, 2012) (J. Cote), and the District Court's decision is currently on appeal to the Second Circuit. *See, e.g.*, Notice of Appeal, No. 11-6355, ECF No. 13 (Jan. 31, 2012). In accordance with the Claims Procedure Order and the Customers Decision, the Trustee developed a comprehensive claims administration process for the intake, reconciliation, and resolution of the customer claims.

### C. The Net Equity Decision

In a SIPA liquidation, customers share *pro rata* in customer property to the extent of their net equity, as defined in section 78lll(11) of SIPA. SIPC advances funds to the trustee for a

customer with a valid net equity claim, up to the amount of their net equity, if their ratable share of customer property is insufficient to make them whole. Such advances are capped at \$500,000 per customer.

The Trustee determined each customer's "net equity" by crediting the amount of cash deposited by the customer into her BLMIS account, less any amounts withdrawn from her BLMIS customer account, otherwise known as the "Net Investment Method." After certain claimants objected to the Trustee's interpretation of net equity, the Trustee moved for a briefing schedule and hearing on the matter. On March 1, 2010, this Court issued its decision on the net equity issue, approving the Trustee's method of determining net equity (the "Net Equity Decision"). *In re Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. 122:

Because 'securities positions' are in fact nonexistent, the Trustee cannot discharge claims upon the false premise that customers' securities positions are what the account statements purport them to be. Rather, the only verifiable amounts that are manifest from the books and records are the cash deposits and withdrawals.

*Id.* at 135.

The Court also concluded that the Trustee's calculation of net equity was consistent with the avoidance powers available to him under SIPA and the Bankruptcy Code, *id.* at 135–38, and that both equity and practicality favor utilizing the Trustee's calculus:

Customer property consists of a limited amount of funds that are available for distribution. Any dollar paid to reimburse a fictitious profit is a dollar no longer available to pay claims for money actually invested. If the Last Statement Method were adopted, Net Winners would receive more favorable treatment by profiting from the principal investments of Net Losers, yielding an inequitable result.

\* \* \*

Equality is achieved in this case by employing the Trustee's method, which looks solely to deposits and withdrawals that in reality occurred.

*Id.* at 141–42.

On March 8, 2010, the Court issued an order approving the Trustee's Net Equity calculation ("Net Equity Order") and certified an appeal of the Net Equity Order directly to the United States Court of Appeals for the Second Circuit. (Net Equity Order, *id.*, ECF No. 2020; Certification of Net Equity Order, *id.*, ECF No. 2022.) On August 16, 2011, the Second Circuit affirmed the Net Equity Decision. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229 (2d Cir. 2011). The Second Circuit held:

if the Trustee had permitted the objecting claimants to recover based on their final account statements, this would have 'affect[ed] the limited amount available for distribution from the customer property found.' [Citing Net Equity Decision, 424 B.R. at 133.] The inequitable consequence of such a scheme would be that those who had already withdrawn cash deriving from imaginary profits in excess of their initial investment would derive additional benefit at the expense of those customers who had not withdrawn funds before the fraud was exposed.

*Id.* at 238. On June 25, 2012, the United States Supreme Court denied *certiorari* review of the Second Circuit's affirmance of the Net Equity Decision. *Velvel v. Picard*, No. 11-986, \_\_\_ S. Ct. \_\_\_, 2012 WL 425188 (U.S. Jun. 25, 2012) (No. 11-986); *Ryan v. Picard*, No. 11-969, \_\_\_ S. Ct. \_\_\_, 2012 WL 396489 (U.S. June 25, 2012).

**D. The Trustee's Litigation Against the Merkin Defendants and Merkin Funds**

The Trustee commenced his Merkin Action against the Merkin Defendants and the Merkin Funds on May 6, 2009 (Adv. Pro. No. 09-1182) in this Court. The Trustee seeks to avoid and recover more than \$500 million in avoidable transfers held by the Merkin Defendants and the Merkin Funds, for equitable distribution to the victims of the Ponzi scheme. The Defendants represent potential beneficiaries of this recovery.

In his complaint (the "Trustee's Complaint"), the Trustee alleges that Merkin, a sophisticated investment manager with close business and social ties to Madoff, steered hundreds of millions of dollars from the Merkin Funds into BLMIS through his solely held corporation, GCC, and that the Merkin Funds and Merkin Defendants withdrew more than \$500 million from

BLMIS from at least 1995 to 2008. (Powers Decl. Ex. C ¶ 2, Ex. B.) The Merkin Defendants knew or should have known that BLMIS was predicated on fraud, as they were on notice of myriad indicia of fraud, but failed to diligently investigate. (*Id.* ¶¶ 2, 32, 34, 44.) The Merkin Defendants received substantial fees and commissions from BLMIS in connection with their management of the Merkin Funds. (*Id.* ¶¶ 42, 106.)

The Trustee's Complaint seeks the recovery from the Merkin Defendants and the Merkin Funds of BLMIS customer property under SIPA §§ 78fff(b), 78fff-1(a), and 78fff-2(c)(3), §§ 105(a), 502(d), 542, 544, 547, 548(a), 550(a) and 551 of the Bankruptcy Code, the New York Fraudulent Conveyance Act (N.Y. Debt. & Cred. §§ 270 *et seq.*) and N.Y. C.P.L.R. 203(g). The Trustee also seeks the imposition of a constructive trust and disallowance of claims. (*Id.* ¶¶ 114–118, Prayer ¶ xv.) On December 23, 2009, the Trustee amended his Complaint to add a new count seeking recovery from Merkin personally, based upon his position as general partner of Ascot Fund and Ascot Fund's insolvency and inability to pay any judgments rendered against it, for all preferential and fraudulent transfers made from BLMIS to Ascot Fund. (Powers Decl. Ex. D.) These transfers total in excess of \$500 million. (*Id.* Complaint Ex. B.)

On January 25, 2010, the Merkin Defendants, Ariel Fund, and Gabriel Fund renewed Motions to Dismiss the Trustee's Amended Complaint. (ECF Nos. 53, 55.) On November 17, 2010, this Court entered a Decision and Order denying the Motions to Dismiss as to all Counts, with the exception of claims for immediate turnover under section 542 and preferential transfers.<sup>7</sup> (ECF No. 84.) The Court held that the Trustee alleged viable claims for actual fraudulent transfers, constructive fraudulent transfers, undiscovered fraudulent transfers, subsequent transfers to the Merkin Defendants, and general partner liability of Merkin,

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<sup>7</sup> There were no preferential transfers made to Ariel Fund and Gabriel Fund. The only preferential transfers at issue were made to Ascot Fund.

specifically holding that voidable transfers received by Ascot Fund could be recovered from Merkin as Ascot Fund's sole general partner. (ECF No. 84 at 3, 12–31, 34–38.) Bart M. Schwartz, as receiver for Ariel Fund and Gabriel Fund, filed a Motion for Leave to Appeal with the District Court. (Case No. 1:11-mc-00012-KMW, ECF No. 1.), and that motion was denied on August 31, 2011. (*Id.*, ECF No. 9.) Meanwhile, discovery in the Trustee's Action is very far along, with fact discovery to be completed November 2nd of this year. (Powers Decl. ¶ 6.)<sup>8</sup>

**E. The New York Attorney General's Settlement and the Third Party Actions**

The NYAG Settlement relates to at least two actions, one brought by the NYAG, and one brought by Schwartz as receiver for Ariel Fund and Gabriel Fund.<sup>9</sup> The Settlement appears to have a process in place to resolve other pending litigation, as well, with respect to investors in the Merkin Funds, as discussed below.

**1. *Eric T. Schneiderman, as successor to Andrew M. Cuomo, Attorney General of the State of New York v. J. Ezra Merkin, et al., Index No. 450879/2009 (N.Y. Sup. Ct.) (Lowe, J.)***

On or about April 6, 2009, the NYAG commenced the NYAG Action against the Merkin Defendants to benefit investors in the Merkin Funds, in the Supreme Court of the State of New York, County of New York. The NYAG Action is pending before Judge Richard Lowe. The NYAG seeks restitution and compensatory damages on behalf of the Merkin Funds' investors, attorneys' fees, and other expenses. (Powers Decl. Ex. F at 53–54.) The NYAG also seeks an accounting and an injunction prohibiting the Merkin Defendants from engaging in the securities business in the State of New York, which is not the subject of the instant motion. (*Id.*) The

<sup>8</sup> Motions on behalf of Ariel Fund, Gabriel Fund, and the Merkin Defendants were filed in the Trustee's Merkin Action seeking to withdraw the reference to the district court. Discovery is continuing notwithstanding these motions. (Powers Decl. ¶ 6.)

<sup>9</sup> David Pitofsky, as receiver for Ascot Fund, Ltd. and Ascot Partners, L.P., is participating in the Settlement. Ascot Fund, Ltd. began investing with BLMIS sometime before 1995 and was nearly entirely invested with BLMIS. (Powers Decl. ¶ 4 n.2; *id.* Ex. F ¶ 2.)

stated purposes of the NYAG Action are to promote the “economic health and well-being of investors” and “financial well-being” of non-profit organizations (*id.* ¶ 7) and to seek restitution for the Merkin Defendants’ fraudulent conduct. (*Id.* ¶¶ 9, 13.)

The NYAG’s complaint does not specify the dollar amount sought by the NYAG beyond seeking “all restitution and damages” caused by the complained-of acts. However, prior to the Settlement, the NYAG asserted that he sought to recover nearly \$729 million in fees from the Merkin Defendants (*id.* at 25–28), in addition to damages sought for fictitious profits, attorneys’ fees or other expenses. The NYAG Action thus seeks the funds that allegedly were transferred by BLMIS to the Merkin Funds and Merkin Defendants—the same funds that the Trustee seeks to recover in his litigation for the benefit of all BLMIS customers and creditors. The recovery by the NYAG would significantly reduce the Merkin Defendants’ assets, and possibly exhaust available liquid assets, rendering any victory by the Trustee in his litigation pyrrhic.

Just as the Trustee sets forth in his Complaint, the NYAG alleges that Merkin knew or should have known of the Ponzi scheme and that he failed to conduct proper due diligence over BLMIS. (Powers Decl. Ex. F ¶¶ 101–114.) Notably, the NYAG alleges that “Merkin collected hundreds of millions of dollars in fees for managing investors’ funds, while turning all, or a substantial portion, of those funds over to Madoff and others . . . whom Merkin failed to adequately oversee, audit, or investigate.” (*Id.* ¶ 6; *see also* ¶¶ 1, 19, 29–31, 54, 64, 76.) Significantly, the Trustee has alleged in his Merkin Action that the fees paid to the Merkin Defendants in connection with the Merkin Funds’ BLMIS investments were withdrawn from BLMIS. (Powers Decl. Ex. D ¶¶ 42, 106.) Thus, the NYAG seeks the same hundreds of millions of dollars that were fraudulently transferred by BLMIS to Merkin and that are sought by the Trustee.

On October 18, 2010, the NYAG filed a motion for summary judgment in his state court actions, which was *sub judice* until the time of the Settlement and has been marked off calendar in light of the Settlement. (Powers Decl. Exs. B, G; Dkt. No. 272 (July 19, 2012).)

Various “freeze orders” (the “Freeze Orders”) were entered in the NYAG Action to preserve assets for the NYAG to recover. (*See, e.g.*, Powers Decl. Exs. I–L.) These Freeze Orders have not been enough to prevent the dissipation of Merkin’s assets to date, as the NYAG apparently agreed to allow Merkin to pay to settle at least three other actions, and at least two third party arbitrations have resulted in confirmed arbitration awards, while the Freeze Orders were supposedly in effect.<sup>10</sup> (*See id.* Ex. L.) More importantly, they provide no protection against recovery by the NYAG itself, which has now settled with the Merkin Defendants.

**2. *Bart M. Schwartz, as Receiver for Ariel Fund Ltd. and for Gabriel Capital, L.P. v. J. Ezra Merkin, et al.*, Index No. 651516/2010 (N.Y. Sup. Ct.) (Lowe, J.)**

Bart Schwartz, as receiver for Ariel and Gabriel Funds, is participating in the Settlement. The Schwartz Action, just like the NYAG Action, seeks fraudulently transferred customer property.

On or about September 16, 2010, Ariel Fund and Gabriel Fund, through their court-appointed receiver, Bart Schwartz, commenced the Schwartz Action against the Merkin Defendants in the Supreme Court of the State of New York, County of New York. Through the Schwartz Action, Ariel Fund and Gabriel Fund seek unspecified compensatory, consequential and punitive damages, as well as attorneys’ fees and other expenses and interest. (Powers Decl. Ex. I at Prayer for Relief A, F, G.) The Schwartz Action also seeks “a constructive trust over *all*

<sup>10</sup> The Trustee is considering whether to expend additional resources to pursue the third party plaintiffs in these actions as subsequent transferees: (1) *Congregation Machsikai Torah-Beth Pinchas v. Ascot Partners, L.P., et al.*, Index No. 09-02118 (Mass. Sup. Ct.); (2) *Sandalwood Debt Fund A, L.P., and Sandalwood Debt Fund B, L.P. v. J. Ezra Merkin*, Index No. 651441/2010 (N.Y. Sup. Ct.); and (3) *The Calibre Fund, LLC v. J. Ezra Merkin, et al.*, Index No. 107978/2011 (N.Y. Sup. Ct.).

*assets, property, and/or cash currently in the custody and control of each Defendant*” (*id.* at Prayer for Relief B (emphasis added)), including, among other things, “all assets or compensation received by the Defendants in connection with the business of the Funds.” (*Id.* ¶ 103.) The Schwartz Complaint therefore seeks control over the same \$500 million in fraudulently transferred BLMIS customer property that the Trustee seeks in his Merkin Action. On December 17, 2010, the Merkin Defendants filed a motion to dismiss the Schwartz Action. That motion was pending at the time the Settlement was announced, and has been marked off calendar in light of the Settlement. (*See id.* Ex. M, Dkt. No. 20 (July 19, 2012).)

Like the Trustee’s Complaint, the complaint in the Schwartz Action alleges that the Merkin Defendants benefited from investing with BLMIS, even though they knew or should have known that they were benefiting from a fraud. (Powers Decl. Ex. N ¶¶ 1–3, 46(e) and 56 (alleging that Merkin improperly and without informing plaintiffs turned over responsibility for substantial Fund assets to BLMIS and Madoff despite knowing facts, or being obligated to know facts, that put him on notice that BLMIS was a fraud).) The harm claimed by Ariel Fund and Gabriel Fund stems fundamentally from the BLMIS fraud. More significantly, by seeking a constructive trust over all assets held by the Merkin Defendants, the Funds seek to recover for themselves the same fraudulent transfers of estate property sought by the Trustee. (*See id.* ¶ 103; Prayer for Relief B.) Schwartz has readily acknowledged that the Trustee’s Merkin Action is “already pending,” “relatively well developed,” and “will be better adjudicated” before this Court. (*See* Powers Decl. Ex. H ¶ 24.)

### 3. The Settlement

As announced in Attorney General Schneiderman’s Press Release, the NYAG has “secured a \$410 million settlement with J. Ezra Merkin,” recovering the Merkin Defendants’ management fees in connection with the Merkin Funds. The Settlement apparently seeks to

compensate certain investors in these funds, paying “\$405 million to compensate investors over a three-year period, and \$5 million to the State of New York to cover fees and costs.” (*See* Powers Decl. Ex. H.)

The Settlement consists of a complex, and no doubt costly, system, whereby David Pitofsky and Bart Schwartz, court-appointed Receivers for the Merkin Funds, will direct payments to select investors depending on a determination of whether they were aware of Merkin’s delegation of authority to Madoff: “Depending on the size of their losses, eligible investors will be entitled to receive over 40 percent of their cash losses. Pursuant to a claims process, investors who were not aware of Merkin’s delegation to Madoff will receive a defined percentage of their losses, while those who were aware of Madoff’s role will be eligible to receive a smaller recovery.” (*See* Powers Decl. Ex. A.) The New York State court is to retain continuing jurisdiction over the Settlement. (*Id.*) The NYAG Press Release further states that the select investors who would benefit from the Settlement “are likely to receive additional payments at a future date when the Madoff Estate is able to distribute moneys recovered by Irving Picard.” (*Id.*)

Thus, through the Settlement, the NYAG seeks to: (1) obtain Merkin’s assets to the detriment of the BLMIS estate; (2) for fraudulently transferred assets consisting of other people’s money; (3) for distribution to select investors; (3) to the detriment of all other BLMIS customers; and (4) outside the jurisdiction of this Court. The Settlement is nothing less than an out and out assault on this Court’s jurisdiction over the BLMIS estate and the equitable distribution scheme put into place by this Court and affirmed by the Second Circuit.

The Trustee attempted to obtain a copy of the Settlement Agreement. (Powers Decl. ¶ 9.) Over nearly a one month period, the Trustee engaged in good-faith negotiations with counsel for

various Defendants in an effort to see the precise terms of the Settlement. (*Id.*) Despite agreeing to the material terms of a confidentiality agreement no later than July 11, 2012, the Trustee was informed by counsel for the NYAG on July 26, 2012 that the NYAG would not provide the Settlement Agreement to the Trustee because it would be “premature” to do so. (*Id.*) Accordingly, the Trustee respectfully requests that the Court order the Defendants to produce the Settlement Agreement to the Court, SIPC, and the Trustee.

### ARGUMENT

#### **THE AUTOMATIC STAY AND STAY ORDERS SHOULD BE ENFORCED AND THIS COURT SHOULD ISSUE A PRELIMINARY INJUNCTION**

##### **I. THE COURT SHOULD ORDER DEFENDANTS TO PRODUCE THE SETTLEMENT AGREEMENT**

Federal Rule of Civil Procedure 37, applicable in whole to this proceeding pursuant to Federal Rule of Bankruptcy Procedure 7037, permits a party to move for an order compelling discovery, including the production of documents, upon certification of the party’s good-faith efforts to obtain the requested discovery without court action. Here, the Settlement Agreement affects the Trustee’s interests, and the precise terms of the Agreement are clearly relevant to the issue of whether the Settlement is an improper attempt to control estate property, which will have an adverse effect on the BLMIS estate. Likewise, the Court certainly must review the Settlement Agreement to determine the impact of the Settlement on the BLMIS estate. Despite the Trustee’s repeated efforts to obtain a copy of the Settlement Agreement from the Defendants, the NYAG will not produce it at this time. (*See* Powers Decl. ¶ 9.) As such, an order directing the production of the Settlement Agreement is warranted. *See, e.g., Santrayll v. Burrell*, No. 91-Civ-3166, 1998 WL 24375 (S.D.N.Y. Jan. 22, 1998) (granting motion to compel production of settlement agreement); *White v. Kenneth Warren & Son, Ltd.*, 203 F.R.D. 364 (N.D. Ill. 2001)

(permitting discovery of a settlement agreement that was relevant to the issue of the non-settling defendants' liability).

## II. THIS COURT HAS SUBJECT MATTER AND PERSONAL JURISDICTION

The District Court has three times, in decisions by three judges, affirmed decisions by this Court holding that conduct similar to that of the Defendants violated the automatic stay and was properly enjoined under section 105(a). *See Stahl* Summary Order, 2011 WL 7981599; *Fox*, 2012 WL 990829; *Maxam*, 2012 WL 1570849. As in those cases, this Court has subject matter jurisdiction to enjoin the Third Party Actions pursuant to 28 U.S.C. §§ 1334(b), 157(a), 157(b), and the Amended Standing Order of Reference of the United States District Court for the Southern District of New York, dated January 31, 2012 (Preska, C.J.).

Pursuant to 28 U.S.C. § 1334(b), district courts (and hence bankruptcy courts) have original jurisdiction of civil proceedings “arising under” and “arising in” and “related to” cases under Title 11. *See Adelpia Commc’ns Corp. v. Am. Channel, LLC (In re Adelpia Commc’ns Corp.)*, No. 06-01528, 2006 WL 1529357, at \*6 (Bankr. S.D.N.Y. June 5, 2006). Furthermore, bankruptcy courts have jurisdiction to “hear and determine . . . all core proceedings arising under Title 11, or arising in a case under Title 11 . . . .” 28 U.S.C. § 157(b)(1). *See also* SIPA § 78eee(b)(4). Title 28 U.S.C. §§ 157(b)(2)(A) and (B) provide that core proceedings include, but are not limited to, “matters concerning the administration of the estate . . .” and the “allowance or disallowance of claims against the estate.”

That the Settlement is a recovery of fraudulently transferred funds, and undermines the orderly administration of the liquidation of BLMIS and the Trustee’s efforts to recover the same property and satisfy claims against BLMIS, provides “arising under,” “arising in,” and “related to” jurisdiction to this Court. *See, e.g., Picard v. Stahl*, 443 B.R. at 295 (Bankr. S.D.N.Y. 2011)

(bankruptcy court had jurisdiction to enjoin third party claims that “would be satisfied from the finite pool of funds sought by the Trustee, threatening the Trustee’s ability to recover large potential judgments at the expense of the BLMIS estate.”); *see also AP Indus., Inc. v. SN Phelps & Co. (In re AP Indus., Inc.)*, 117 B.R. 789, 798 (Bankr. S.D.N.Y. 1990) (an adversary proceeding involving matters impacting both the administration and property of the estate is a core proceeding); *Quigley Co. v. Law Offices of Peter G. Angelos (In re Quigley Co.)*, 676 F.3d 45, 57–58 (2d Cir. 2012) (bankruptcy court has jurisdiction over third party claims that “pose[] the specter of direct impact on the *res* of the bankruptcy estate,” even if such claims allege liability not derivative of the debtor’s conduct).

This Court likewise has personal jurisdiction over the Defendants. First, to the extent that the Defendants have, in commencing their Actions and finalizing the Settlement, availed themselves of the courts in New York, this is sufficient to establish personal jurisdiction. *In re Sayeh R.*, 693 N.E.2d 724, 727–28 (N.Y. 1997) (“[u]se of the New York courts is a traditional justification for the exercise of personal jurisdiction over a nonresident.”) Second, the bankruptcy court has personal jurisdiction over the Defendants to the extent necessary to protect its own jurisdiction over the property of the estate and to enforce the automatic stay. *See* 11 U.S.C. § 362(a) (“[A]n application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 [ . . . ] operates as a stay, *applicable to all entities . . .*” (emphasis added)); § 101(15) (“The term ‘entity’ includes person, estate, trust, governmental unit, and United States trustee.”). Finally, each of the Merkin Funds has filed customer claims in the BLMIS liquidation, thereby providing personal jurisdiction over the Funds as well.<sup>11</sup> (*See* Cohen

<sup>11</sup> While Ascot Fund, Ltd. did not file a claim, as noted above, this entity has been subsumed by Ascot Partners, L.P., which did file a claim in the liquidation.

Aff. Exs. A–C.) *Stahl*, 443 B.R. at 310 (citing *Langenkamp v. Culp*, 498 U.S. 42, 44 (1990)); *Keller v. Blinder (In re Blinder Robinson & Co.)*, 135 B.R. 892, 896–97 (D. Col. 1991).

### III. THE SETTLEMENT VIOLATES THE AUTOMATIC STAY AND STAY ORDERS

#### A. The Automatic Stay, SIPA and the Stay Orders Apply

Section 362(a)(3) of the Bankruptcy Code provides that the filing of an application for the entry of a protective decree under section 5(a)(3) of SIPA (15 U.S.C. § 78eee(a)(3)) operates as a stay, applicable to all persons and entities of, *inter alia*, any act to exercise control over property of the estate. *See* 11 U.S.C. § 362(a)(3). Similarly, section 362(a)(1) bars “the commencement or continuation . . . of a judicial . . . or other action or proceeding against the debtor . . . or to recover a claim against the debtor . . . .” 11 U.S.C. § 362(a)(1). A “claim against the debtor” encompasses claims against third parties, such as claims for fraudulently transferred funds, that are tantamount to claims against the debtor. *See FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125, 132 (2d Cir. 1992). Finally, section 362(a)(6) bars “any act to collect, assess or recover a claim against the debtor that arose before the commencement of the case.” 11 U.S.C. § 362(a)(6). Because the Settlement seeks recovery of (or recovery from) the same fraudulent transfers sought by the Trustee, the Settlement seeks to collect on (or out of) the Trustee’s fraudulent transfer claims and is in violation of the automatic stay.

In addition to the automatic stay, the December 15 Stay Order, which implements SIPA § 78eee(b)(2)(A) and (B), is applicable here. SIPA § 78eee(b)(2)(A) gives exclusive jurisdiction to this Court over debtor’s property wherever located and SIPA § 78eee(b)(2)(B) provides for stay protection as to, *inter alia*, any suit against the debtor’s property. To the extent the Third Party Actions seek to assert disguised fraudulent transfer claims seeking to recover funds received by the Merkin Defendants or Merkin Funds in connection with their involvement with

BLMIS, they therefore violate these sections of SIPA. The December 15, 2008 Stay Order thus serves to stop these Defendants from interfering with potential estate assets. *See Fox*, 429 B.R. at 433; *Stahl*, 443 B.R. at 315; *Maxam*, 2012 WL 1570859, at \*8.

Each of the provisions of section 362(a) is designed to prevent the dismemberment of the bankruptcy estate through interference, either directly or indirectly, with the trustee's control over estate property. *See, e.g., Liberty Mut. Ins. Co. v. Off. Unsecured Creditors' Comm. of Spaulding Composites Co. (In re Spaulding Composites Co.)*, 207 B.R. 899, 908 (B.A.P. 9th Cir. 1997); *In re Burgess*, 234 B.R. 793, 799 (D. Nev. 1999); *In re HSM Kennewick, L.P.*, 347 B.R. 569, 572 (Bankr. N.D. Tex. 2006). The Settlement and the underlying actions are derivative of the Trustee's claims to the extent that they are based on the same facts, seek the same funds from the same defendants, and are inextricably intertwined with the Trustee's claims. Even to the extent that they are not derivative of the Trustee's claims, "[a] suit against a third party alleging liability not derivative of the debtor's conduct but that nevertheless poses the specter of direct impact on the *res* of the bankrupt estate may just as surely impair the bankruptcy court's ability to make a fair distribution of the bankrupt's assets as a third-party suit alleging derivative liability." *Quigley*, 676 F.3d at 58.

"The automatic stay is one of the most fundamental bankruptcy protections . . ." *Fox*, 429 B.R. at 430. The stay provision is broad, and "prevents creditors from reaching the assets of the debtor's estate piecemeal and preserves the debtor's estate so that all creditors and their claims can be assembled in the bankruptcy court for a single organized proceeding." *In re AP Indus., Inc.*, 117 B.R. at 798 (citations omitted). Similarly, in this SIPA action, the automatic stay "protects customers of BLMIS by fostering fair, uniform, and efficient distribution of customer property." *Fox*, 429 B.R. at 430. The automatic stay is intended precisely to prevent

those creditors who are able to act first from obtaining payment “in preference to and to the detriment of other creditors . . . [.]” See *In re AP Indus., Inc.*, 117 B.R. at 799 (citing H.R. Rep. 595, 95th Cong., 1st Sess. 342 (1977) reprinted in (1978) U.S. Code & Cong. News 5963; S. Rep. No. 989, 95th Cong., 2d Sess. 51, reprinted in (1978) U.S. Code & Cong. News 5787); *Keene Corp. v. Coleman (In re Keene Corp.)*, 164 B.R. 844, 849 (Bankr. S.D.N.Y. 1994) (“equality . . . is the governing principle”). This would be the exact result if the settlement funds were disbursed before the conclusion of the Trustee’s Merkin Action.

**B. The Settlement Seeks to Recover Fraudulently Transferred Funds in Violation of Section 362(a)(1)**

The Settlement (as well as the litigation that underlies it) seeks to recover the same funds from the Merkin Defendants and the Merkin Funds that are sought by the Trustee. To the extent that the underlying Third Party Actions seek a constructive trust over all funds held by the Merkin Defendants or the recovery of all funds received by the Merkin Defendants in connection with BLMIS, the actions are—on their face—for the same fraudulent transfers received from BLMIS. Moreover, the Third Party Actions seek the recovery, as restitution or disgorgement, of fees paid to the Merkin Defendants. (Schwartz Compl. ¶ 103; NYAG’s Mem. of Law in Supp. of Mot. for S.J. at 24–28.) As the Trustee has alleged, these fees and commissions were paid to the Merkin Defendants through transfers from BLMIS—the same transfers sought by the Trustee. (Tr. Compl. ¶¶ 42, 106.)

The automatic stay, reinforced by the Stay Orders, prohibits third parties from seeking to recover fraudulently transferred funds: “a third-party action to recover fraudulently transferred property is properly regarded as undertaken ‘to recover a claim against the debtor’ and subject to the automatic stay pursuant to § 362(a)(1).” *In re Colonial Realty Co.*, 980 F.2d at 131–32; *Fox*, 2012 WL 990829, at \*7; see also *In re Keene Corp.*, 164 B.R. at 850 (“Where a [debtor’s]

creditor seeks to recover his or her claim from a transferee of [the debtor's] property, the creditor's action is stayed by Section 362(a)(1)."); *Crysen/Montenay Energy Co. v. Esselen Assocs., Inc. (In re Crysen/Montenay Energy Co.)*, 902 F.2d 1098, 1103 (2d Cir. 1990) (unsecured creditor should not be able to obtain priority over other unsecured creditors, and action by such creditor to recover its claim against third party defendant found to be in violation of stay).

Similarly, the Settlement and underlying actions attempt to recover fraudulent transfers of BLMIS estate property and should be barred. The Defendants cannot disguise an attempt to recover the proceeds of fraudulent transfers by claiming to seek money damages. *See Fox*, 2012 WL 990829 at \*10 (third party claims violated the automatic stay notwithstanding the names of the causes of action); *In re AP Indus., Inc.*, 117 B.R. at 801; *Stahl*, 443 B.R. at 314; *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Bernard L. Madoff)*, \_\_\_ B.R. \_\_\_, 2012 WL 2377787 (Bankr. S.D.N.Y. Jun. 20, 2012) (ECF No. 4900) (denying motion to lift the automatic stay to file class action where plaintiffs "simply repeated, repackaged, and relabeled the wrongs alleged by the Trustee in an attempt to create independent claims where none exist"); *In re Saunders*, 101 B.R. 303, 305–06 (Bankr. N.D. Fla. 1989) (citing legislative history indicating that chief concern underlying section 362(a)(1) was to prevent a creditor from recovering on a claim against the debtor "from property that should have been available for levy and execution but for the transfer to a third party in fraud of creditors").

**C. The Settlement Seeks to Collect or Recover on the Trustee's Claims in Violation of Section 362(a)(6)**

In any event, no matter how they characterize their damages, the Settlement and underlying actions seek to recover for the loss of funds invested in BLMIS and the damages sought consist of funds wrongly transferred from BLMIS. They, therefore, additionally violate

section 362(a)(6), which prohibits acts to collect or recover a claim against the debtor. The transfers that the Merkin Defendants and Merkin Funds received in connection with BLMIS included, as the Trustee has alleged in his Complaint, more than \$500 million of customer funds. (See Powers Decl. Ex. D at Ex. B.) The only money held by Ascot Fund is money that was wrongfully transferred as part of Madoff's Ponzi scheme (see Powers Decl. ¶ 4 n.2; Ex. F ¶ 2), so that any "damages" recovered from it will necessarily consist of property of the estate. Based on the Trustee's investigation to date, the Trustee believes that neither the Merkin Defendants nor Ascot Fund can satisfy both the amount purportedly due under the Settlement and the over \$500 million the Trustee seeks in his litigation. (See Powers Decl. ¶ 8.) Thus, the Settlement would deplete the pool of fraudulently transferred property available for recovery by the estate.

By seeking recovery of (or recovery out of) the same transfers sought by the Trustee, the Settlement and the underlying actions are seeking to collect on the Trustee's claims, thus prejudicing the Trustee's ability to pursue his claims. See *Sosne v. Reinert & Duree, P.C. (In re Just Brakes Corporate Sys., Inc.)*, 108 F.3d 881, 884 (8th Cir. 1997) (creditor's collection on a pre-petition judgment out of property that the Trustee was pursuing in his fraudulent transfer claim violated § 362(a)(6) because it "prejudiced the Trustee's ability to litigate a competing avoidance claim on behalf of all creditors and was therefore inconsistent with the basic purpose of the automatic stay"); see also *Stahl* Ruling, 2011 WL 7975167, at \*14 (in affirming *Stahl* decision, finding *Just Brakes* "the closest case that I found, and which I believe is persuasive . . ."); 3 COLLIER ON BANKRUPTCY ¶ 362.03[8][c] (16th ed. 2010) ("The stay does apply, however, to an attempt to collect a prepetition claim out of property that was fraudulently transferred by the debtor before the commencement of the case;" although the property is not itself property of the estate, "[t]he fraudulent transfer action belongs to the estate, and a creditor's attempt to

recover out of fraudulently conveyed property is stayed”). The NYAG’s effort through the Settlement to recover, or recover from, the proceeds of fraudulent transfers received by the Merkin Defendants and Merkin Funds is an improper attempt to collect on the Trustee’s claims against these defendants and is thus precluded by section 362(a)(6).

**D. The Defendants Exercise Control Over Property of the Estate and Implicate BLMIS’ Property Interests in Violation of Section 362(a)(3)**

Section 362(a)(3) applies the automatic stay to any act to exercise control over property of the estate or customer property. “Indeed, every *conceivable* interest of the debtor, future, nonpossessory, *contingent*, speculative, and derivative, is within the reach of the term ‘property of the estate.’” *Fox*, 2012 WL 990829, at \*7 (emphasis added). Actions that have the effect of exercising control over property of the estate or customer property, or where the actions “necessarily implicate” a debtor’s property interests, violate Bankruptcy Code § 362(a)(3), regardless of whether the debtor is named in the action. *Adelphia*, 2006 WL 1529357, at \*3 (granting TRO because third party suit threatened to interfere with debtor’s realization of value of its assets and its reorganization); *In re MCEG Prods., Inc.*, 133 B.R. 232, 235 (Bankr. C.D. Cal. 1991) (third party suit to enjoin sale by debtor violated automatic stay because it affected debtor’s rights in sale agreement). Section 362(a)(3) protects the *in rem* jurisdiction of the Court, and prohibits interference with the disposition of the assets that are under the Court’s wing, whether or not the debtor is named as a defendant as part of that effort. And this is so regardless of the form the interference takes. *See Adelphia*, 2006 WL 1529357, at \*3. Critically, courts look to the substance and not the form of the purported action. *See 48th St. Steakhouse, Inc. v. Rockefeller Grp., Inc. (In re 48th St. Steakhouse, Inc.)*, 835 F.2d 427, 431 (2d Cir. 1987) (“If action taken against the non-bankrupt party would inevitably have an adverse impact on property of the bankrupt estate, then such action should be barred by the automatic stay.”).

The Settlement and the underlying actions seek to recover from the Merkin Defendants for claims arising out of the BLMIS fraud and based on substantially the same operative facts as those alleged by the Trustee. By settling these actions, the Defendants are attempting to exercise control over causes of action that belong to the Trustee, which are property of the estate. *See Jackson v. Novak (In re Jackson)*, 593 F.3d 171, 176 (2d Cir. 2010). Moreover, the Defendants seek to recover from property that was improperly transferred to the Merkin Defendants and the Merkin Funds—funds that the Trustee seeks to recover in connection with the Trustee’s Merkin Action. The Settlement will “inevitably have an adverse impact on the property of the estate,” *See 48th St. Steakhouse*, 835 F.2d at 431, and constitutes a clear violation of the automatic stay. *See Quigley*, 676 F.3d at 57–58 (bankruptcy court has jurisdiction over third party claims that even “pose[] the specter of direct impact on the *res* of the bankrupt estate).

**E. The NYAG Action and Settlement Are Not Exempt From the Automatic Stay and the Stay Orders**

Section 362(b)(4) of the Bankruptcy Code provides that the filing of a bankruptcy proceeding does not operate as a stay against “the commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such governmental unit’s or organization’s *police and regulatory power*, including the enforcement of a judgment other than a monetary judgment,” obtained in such an action. 11 U.S.C. § 362(b)(4) (emphasis added). This section was intended to “be given a narrow construction” to permit the government to “pursue action to protect the public health and safety,” but not to apply to government actions brought “to protect a pecuniary interest in property of the debtor or property of the estate.” *In re Chateaugay Corp.*, 115 B.R. 28, 32 (Bankr. S.D.N.Y. 1988) (citing legislative history) (emphasis in original removed). The exception therefore applies if the purpose of the law sought to be enforced by the government action is to “promote ‘public safety and welfare’ or to effectuate public policy.”

*Enron Corp. v. California (In re Enron Corp.)*, 314 B.R. 524, 535 (Bankr. S.D.N.Y. 2004) (citation omitted). If, however, the purpose of the law “relates to the protection of the government’s pecuniary interest in the debtor’s property,” or to adjudicate private rights, the exception is inapplicable and the automatic stay applies.” *Id.* (citation omitted).

Where, as here, the primary purpose of a litigation brought by a governmental unit “is to seek restitution for wrongs to its citizens,” the police and regulatory power exception to the automatic stay is not implicated. *Id.* at 536; *see also In re Nortel Networks, Inc.*, 669 F.3d 128, 142 (3d Cir. 2011). In *Enron*, the California Attorney General brought an action under California consumer protection laws seeking both injunctive relief and money damages including restitution, disgorgement and civil penalties. 314 B.R. at 535–36. The Attorney General had stated publicly that the purpose of the litigation was to seek “a different pot of money” to compensate the state and its citizens for the defendants’ market manipulations. *Id.* at 536. The court found that the primary purpose of the litigation was to protect the government’s pecuniary interest, and that by bringing the action for the primary purpose of restitution, the Attorney General had “sought to adjudicate the rights of a private litigant.” *Id.* at 540. Accordingly, the lawsuit was found to be barred by the automatic stay and void *ab initio*. *Id.* at 541. In other words, when a governmental unit acts for the financial benefit of specific creditors, as the NYAG does here, it is not acting in a regulatory capacity and does not enjoy the protection of section 362(b)(4). *See id.*; *see also Nortel*, 669 F.3d at 142; *In re Baldwin-United Corp. (Single Premium Deferred Annuities Ins. Litig.)*, 770 F.2d 328, 341 (2d Cir. 1985).

Similarly, in *Nortel*, the Third Circuit confirmed that, when the focus of the third party action is not to prevent acts that threaten public safety and welfare but instead to obtain a pecuniary benefit for a private party, the automatic stay applies. *Nortel*, 669 F.3d at 141. In

*Nortel*, the court determined that actions taken by a foreign pension fund protection agency were not precluded by the automatic stay. *Id.* at 141–42. The court began by noting the purpose of the police power exception:

This exception discourages debtors from submitting bankruptcy petitions either primarily or solely for the purpose of evading impending governmental efforts to invoke the governmental police powers to enjoin or deter ongoing debtor conduct which would seriously threaten the public safety and welfare (*e.g.*, environmental and/or consumer protection regulations).

*Id.* at 137 (quoting *McMullen v. Seigny (In re McMullen)*, 386 F.3d 320, 324–25 (1st Cir. 2004)).

The court noted that the Third Circuit has typically held that regulatory proceedings relating to such issues as “environmental hazards, health and safety violations, and employment discrimination” could constitute appropriate exceptions to the automatic stay. *Id.* at 140. The court determined that the foreign pension proceedings did not fit within the purpose of section 362(b)(4) because they did not relate to public health or safety nor were the proceedings “predicated upon any allegation of wrongdoing” by the debtor. *Id.* at 141.

The court went on to apply the pecuniary purpose and public policy tests, which it described as “designed to sort out cases in which the government is bringing suit in furtherance of either its own or certain private parties’ interest in obtaining a pecuniary advantage over other creditors.” *Id.* at 140 (internal quotations and emphasis omitted). Applying the two tests, the court determined that the action had been brought for the pecuniary purpose of recovering pension fund proceeds for the benefit of the members of the occupational pension fund and the pension protection agency itself, and served no public purpose as it sought to adjudicate private rights. *Id.* at 141–42. Accordingly, the police power exception did not apply.

The same result is warranted here. The NYAG Action has been brought for the primary purpose of obtaining “restitution,” and to vindicate the “economic” and “financial” well-being of citizens. (*See Powers Decl. Ex. F ¶¶ 7, 13.*) And the resulting Settlement provides an economic

benefit to a subset of indirect BLMIS investors. Like the California Attorney General in *Enron* and the pension fund protection agency in *Nortel*, the NYAG is acting on behalf of certain private litigants, and is therefore subject to the automatic stay.

While a lone district court in the Eastern District of New York has broadened the exception to the stay by applying a “pecuniary advantage” test, under which the relevant inquiry is “whether the specific acts that the government wishes to carry out would create a pecuniary advantage for the government vis-à-vis other creditors,” *United States ex rel Fullington v. Parkway Hospital, Inc.*, 351 B.R. 280, 283 (Bankr. E.D.N.Y. 2006), that test would be of no avail to the NYAG here either. Even if the pecuniary interest of New York State were a valid consideration, the primary purpose of the NYAG Action is to adjudicate private rights by awarding restitution to certain indirect investors. *Cf. Fullington*, 351 B.R. at 288–89 (section 362(b)(4) exception applied to Department of Justice action seeking restitution to the government for frauds committed upon national treasury).

In any event, under any test and for any action, the exception to the automatic stay does not extend to the enforcement of a money judgment or its equivalent, which the Settlement is or will be once ordered by the state court. *See* 11 U.S.C. § 362(b)(4) (providing exception to stay for enforcement of a judgment “other than a money judgment” obtained by a governmental unit enforcing its police and regulatory powers); *see, e.g., Fullington*, 351 B.R. at 286. It is clear that “a governmental unit . . . may not enforce a money judgment or seize or seek control over property of the estate without first obtaining relief from the stay.” 3 COLLIER ON BANKRUPTCY ¶ 362.05[5][a] (16th ed. 2010). Otherwise, “enforcement of a money judgment would give the governmental unit an unfair advantage over other creditors [and] would effectively subvert the scheme of priorities set forth in section 507 . . . .” *Id.* at 362.05[b].

The settlement is, or will be, a “money judgment” payable from potential property of the estate, once ordered by the state court. *See, e.g., Penn Terra Ltd. v. Dep’t of Env’tl. Res.*, 733 F.2d 267, 275 (3d Cir. 1984) (“a money judgment is an order entered by the court or by the clerk . . . which adjudges that the defendant shall pay a sum of money to the plaintiff”); *Kirschenbaum v. Nassau Cnty. Dist. Attorney (In re Vitta)*, 402 B.R. 553 (Bankr. E.D.N.Y. 2009), *rev’d on other grounds*, 409 B.R. 6 (Bankr. E.D.N.Y. 2009) (state’s attempt to enforce a stipulation with a chapter 7 debtor concluding the state’s forfeiture action against the debtor constitutes an action to enforce a “money judgment” in violation of the automatic stay). Therefore, even if the NYAG Action were a “proper exercise of the police power, the collection of a money judgment is barred by the stay and can only occur (if at all) in the bankruptcy court . . . .” *Enron*, 314 B.R. at 534. Given the risk that the Settlement will be a “money judgment,” it was incumbent on the NYAG to come to this Court for approval. *See Picard v. Fox*, 429 B.R. at 436–37 (third party actions against the same defendants named in the Trustee’s action potentially undermined the Court’s jurisdiction, “as further prosecution [of the actions] could ultimately result in another court’s determining how potential estate funds are distributed among certain BLMIS customers.”)<sup>12</sup>

**IV. THE THIRD PARTY PLAINTIFFS SHOULD BE PRELIMINARILY ENJOINED PURSUANT TO SECTION 105(A) OF THE BANKRUPTCY CODE TO ALLOW FOR THE FAIR AND EQUITABLE ADMINISTRATION OF THE BLMIS ESTATE**

The automatic stay should be extended and the Defendants should be enjoined under section 105(a) of the Bankruptcy Code from effectuating the Settlement given, among other things, the adverse economic impact on the estate if the Settlement and underlying actions are

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<sup>12</sup> Inasmuch as the NYAG Action violates the automatic stay, it likewise cannot escape the reach of the Stay Orders and SIPA §§ 78eee(b)(2)(A) and (B).

allowed to go forward. *See, e.g., Quigley*, 676 F. 3d at 53; *Fox*, 429 B.R. at 434–37; *Stahl*, 443 B.R. at 315–16. As the Trustee set forth in his Complaint, the Merkin Defendants and the Merkin Funds possess fraudulently transferred BLMIS estate property that must be marshaled and equitably distributed by the Trustee. (*See Powers Decl. Ex. D ¶¶ 2, 14, 32–42, 45–50.*) The Settlement would deplete assets that ultimately belong to the estate.

#### A. Standard for a Section 105(a) Injunction

Section 105(a) of the Bankruptcy Code, applicable here pursuant to section 78fff(b) of SIPA, bestows on bankruptcy courts broad discretion to “issue any order ‘necessary or appropriate to carry out the provisions of [the Bankruptcy Code]’ . . . .” Courts in this Circuit have held that section 105(a) authorizes bankruptcy courts to issue injunctions, and because the injunctions are authorized by statute, the standard for Rule 7065 injunctions is inapplicable. *Fox*, 429 B.R. at 436 (“Because injunctions under section 105(a) are authorized by statute, they need not comply with traditional requirements of Rule 65”); *LaMonica v. N. of Eng. Protecting & Indemn. Ass’n (In re Probulk Inc.)*, 407 B.R. 56, 63 (Bankr. S.D.N.Y. 2009). The Court may enjoin suits if: (i) a third party suit would impair the court’s jurisdiction with respect to a case before it, or (ii) the third party suits threaten to thwart or frustrate the debtor’s reorganization efforts and the stay is necessary to preserve or protect the debtor’s estate.<sup>13</sup> *See Fox*, 429 B.R. at 436; *Stahl*, 443 B.R. at 318; *Calpine Corp. v. Nev. Power Co. (In re Calpine Corp.)*, 354 B.R.

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<sup>13</sup> Notwithstanding that the Rule 7065 standard need not be satisfied here, it easily is. There is no question that an infringement on this Court’s jurisdiction constitutes “irreparable harm.” *Adelphia*, 2006 WL 1529357, at \*5. Moreover, the Trustee is likely to succeed on the merits of his Complaint and demonstrate that the Defendants have violated the automatic stay, as demonstrated herein. *See id.* at \*4–5; *see Fox*, 429 B.R. at 436 n.14; *Stahl*, 443 B.R. at 318 n.24.

45, 58 (Bankr. S.D.N.Y. 2006) *aff'd*, 365 B.R. 401 (S.D.N.Y. 2007); *Fisher v. Apostolou*, 155 F.3d 876, 882 (7th Cir. 1998).<sup>14</sup>

Courts have routinely used section 105(a) to extend section 362 to third party actions against non-debtor entities “when a claim against the non-debtor will have an immediate adverse economic consequence for the debtor’s estate.” *Fox*, 429 B.R. at 434 (quoting *Queenie, Ltd. v. Nygard Int’l*, 321 F.3d 282, 287 (2d Cir. 2003)). For example, the district court, in affirming a bankruptcy court decision enjoining certain third party litigation, held that an injunction was properly granted pursuant to section 105(a) and the court accordingly did not need to consider whether section 362 was also applicable. *Nev. Power Co. v. Calpine Corp. (In re Calpine Corp.)*, 365 B.R. 401, 409 n.20 (S.D.N.Y. 2007); *see also Kagan v. Saint Vincents Catholic Med. Ctrs. of N.Y. (In re Saint Vincents Catholic Med. Ctrs. of N.Y.)*, 449 B.R. 209, 217 (S.D.N.Y. 2011) (the bankruptcy court has authority under section 105 broader than the automatic stay provisions of section 362); *In re Lyondell Chem. Co.*, 402 B.R. at 587 n.33) (court, in granting a limited injunction to stay non-debtor litigation, noted that section 105(a) could be used to enjoin acts against non-debtor entities even when section 362 protection was not available); *In re Wingspread Corp.*, 92 B.R. at 94 (“The basic purpose of [section 105(a)] is to enable the court to do whatever is necessary to aid its jurisdiction . . . .”); *In re Neuman*, 71 B.R. at 571 (under section 105 the bankruptcy court has broad powers to issue injunctions notwithstanding the inapplicability of the automatic stay provisions).

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<sup>14</sup> *See also In re Adelpia Commc'ns Corp.*, 298 B.R. 49, 54 (S.D.N.Y. 2003); *Lyondell Chem. Co. v. CenterPoint Energy Gas Servs. Inc. (In re Lyondell Chem. Co.)*, 402 B.R. 571, 588 n.37 (Bankr. S.D.N.Y. 2009); *Keene Corp. v. Acstar Ins. Co. (In re Keene Corp.)*, 162 B.R. 935, 944 (Bankr. S.D.N.Y. 1994); *E. Air Lines, Inc. v. Rolleston (In re Ionosphere Clubs, Inc.)*, 111 B.R. 423, 431 (Bankr. S.D.N.Y. 1990), *aff'd in part*, 124 B.R. 635 (S.D.N.Y. 1991); *Garrity v. Leffler (In re Neuman)*, 71 B.R. 567, 571–72 (S.D.N.Y. 1987); *C & J Clark Am., Inc. v. Carol Ruth, Inc. (In re Wingspread Corp.)*, 92 B.R. 87, 92 (Bankr. S.D.N.Y. 1988); *LTV Steel Co. v. Bd. of Educ. (In re Chateaugay Corp.)*, 93 B.R. 26, 29 (S.D.N.Y. 1988).

**B. The Settlement and Underlying Actions Threaten the Court's Jurisdiction and the Administration of the Estate and an Injunction Is Necessary to Preserve and Protect the Estate**

As described above, the Settlement purports to resolve claims that are inextricably intertwined with the Trustee's claims, and threatens to allow certain indirect investors of BLMIS to recover estate property. Such an outcome would compromise the equitable distribution of customer property under SIPA and circumvent the orders entered by this and other Courts related to the claims process and the calculation of net equity. *See, e.g.*, Net Equity Decision, 424 B.R. 122. Further, such a result would run afoul of the general principle that stakeholders of a bankruptcy estate should not be permitted to race to the courthouse to recover preferentially to the detriment of other stakeholders. *See, e.g., In re Keene Corp.*, 164 B.R. at 849–54; *In re AP Indus., Inc.* 117 B.R. at 799; *Johns-Manville Corp. v. Colo. Ins. Guar. Ass'n (In re Johns-Manville Corp.)*, 91 B.R. 225, 228–29 (Bankr. S.D.N.Y. 1988); *McHale v. Alvarez (In re 1031 Tax Grp., LLC)*, 397 B.R. 670, 686 (Bankr. S.D.N.Y. 2008). It would also frustrate the goals of SIPA, pursuant to which investors that held investment accounts with BLMIS have preferential claims to the BLMIS customer property fund. *See* SIPA § 78III(2). The Defendants' conduct is just the sort of behavior that courts in this and other jurisdictions have prohibited time after time. *See, e.g., In re Keene Corp.*, 164 B.R. at 849, 854; *In re AP Indus., Inc.*, 117 B.R. at 801–02; *In re Johns-Manville Corp.*, 91 B.R. at 228, *In re 1031 Tax Grp., LLC*, 397 B.R. at 684–85; *Singer Co. B.V. v. Groz Beckert KG (In re Singer Co. N.V.)*, No. 99–10578, 2000 WL 33716976, at \*5–7 (Bankr. S.D.N.Y. Nov. 3, 2000); *Apostolou*, 155 F.3d 876.

The District Court already has three times affirmed this Court's decision that a section 105(a) injunction was necessary to protect the court's jurisdiction and the administration of the

liquidation.<sup>15</sup> In *Fox*, *Stahl*, and *Maxam*, this Court enjoined the defendants therein from prosecuting actions against parties being sued by the Trustee. In addition to finding that the defendants in those actions had usurped causes of actions belonging to the Trustee, the Court found that the third party actions at issue in those cases would have “an immediate adverse economic consequence for the debtor’s estate.” *Stahl*, 443 B.R. at 316 (quoting *Queenie*, 321 F.3d at 287). Further, as the District Court held in affirming *Fox*, a section 105(a) injunction is proper even if the claims asserted are not property of the estate because the overlap between the claims asserted in the Trustee’s Merkin Action and the Third Party Actions is “so closely related that allowing the [Defendants] to convert the bankruptcy proceedings into a race to the courthouse would derail the bankruptcy proceedings.” See *Fox*, 2012 WL 990829, at \*15 (quoting *Apostolou*, 155 F.3d at 883); *Maxam*, 2012 WL 1570859 at \*8–9 (action against Trustee in Cayman Islands threatened Bankruptcy Court’s exclusive *in rem* jurisdiction over estate, and enforcement of automatic stay and injunction under § 105 warranted).

In affirming the *Stahl* decision, the District Court held that the third party actions at issue there “substantially interfere[d] with the ability of the trustee to move in his cases to recover assets for the estate as a whole,” and had an adverse impact on property of the estate because the money recovered by the third party plaintiffs in any judgment “would inevitably be the money that the trustee sought to recover.” See *Stahl* Ruling, 2011 WL 7975167, at \*12, \*15. Like the

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<sup>15</sup> In addition, this Court has held that a section 105(a) injunction was necessary to protect its jurisdiction and the administration of the liquidation in the context of an interpleader action to determine the ownership of funds that constitute customer property. In an order dated June 17, 2009, this Court ruled that an injunction pursuant to Federal Rule of Civil Procedure 65 and section 105(a) was proper to stay an action commenced by Maxam Absolute Return Fund LP and its investment adviser, Maxam Capital Management LLC, against Bank of America, N.A. in the District of Connecticut. (See Powers Decl. Ex. O.) In granting the injunction, the Court stated, “I do see that the Connecticut action would impact on the jurisdiction of this Court especially with respect to the issue of customer property.” (See Powers Decl. Ex. P, *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, Adv. Pro. No. 08-01789, Hr’g Tr. at 28:21–23.)

third party actions in *Stahl*, the Settlement interferes with the Trustee's ability to recover in his Merkin Action, and should likewise be enjoined pursuant to section 105(a).

As this Court discussed in *Fox* and *Stahl*, and as the District Court recognized in affirming *Fox* and *Stahl*, the Seventh Circuit, faced with a similar scenario, also found the use of a section 105(a) injunction appropriate. *Fox*, 429 B.R. at 434–35; *Stahl*, 443 B.R. at 316–17; see also *Stahl* Ruling, 2011 WL 7975167, at \*14 (finding *Apostolou* “instructive”); *Fox*, 2012 WL 990829, at \*15. In *Apostolou*, which was a liquidation proceeding, the Seventh Circuit upheld the bankruptcy court's issuance of an injunction under § 105(a) to protect the trustee's ability to marshal assets on behalf of the debtor's estate, even when the enjoined action did not directly seek property of the estate. 155 F.3d at 877–88. The bankruptcy court issued an injunction pursuant to § 105(a), which the district court reversed. The Seventh Circuit reversed the district court's determination that the bankruptcy court had exceeded its authority in issuing the injunction, stating that:

While the [investor plaintiffs'] claims are not “property of” the Lakes States estate, it is difficult to imagine how those claims could be more closely “related to” it. They are claims to the same limited pool of money, in the possession of the same defendants, as a result of the same acts, performed by the same individuals, as part of the same conspiracy. We can think of no hypothetical change to this case which would bring it closer to a “property of” case without converting it into one. Even if the “related to” jurisdiction is not as broad under Chapter 7 cases as it is in Chapter 11 cases, it reaches at least this far, for to conclude that the “related to” jurisdiction under Chapter 7 does not extend to the circumstances of this case would be to amend the Bankruptcy Code to eliminate § 105 from Chapter 7 proceedings.

*Id.* at 882 (internal citations omitted).

Notably, some of the plaintiffs in *Apostolou* may have had claims against the defendants based on a “separate and distinct injury” to the individual plaintiff that could not be fully measured by the debts owed to the estate. *Id.* at 881. The court nevertheless held that the investors who were the plaintiffs in those actions “must wait their turn behind the trustee, who

has the responsibility to recover assets for the estate on behalf of the creditors as a whole . . . .”

*Id.* Accordingly, the court stayed the underlying actions pending the outcome of the bankruptcy proceeding: “At that point, the degree to which the Apostolou Plaintiffs have been compensated for their injuries through their share of the assets in the debtors’ estates will be settled, and it will be possible for the district court to proceed with this action against the nondebtor defendants for whatever individualized damages may be proper.” *Id.* at 883.

Similarly, in *In re AP Industries, Inc.*, this Court stated that a bankruptcy court has “authority under § 105 broader than the automatic stay provisions of § 362 and may use its equitable powers to assure the orderly conduct of the reorganization proceedings.” 117 B.R. at 801 (citations omitted). There, the debtor sought to stay or enjoin actions commenced by a creditor against the debtor’s directors and other third parties that were brought because the creditor objected to a transaction entered into by the debtor. The Court found that it was appropriate to use section 105(a) to enjoin the creditor’s action, stating:

this Court finds that it is also appropriate to issue an injunction pursuant to § 105 of the Code to stay the [creditor’s] Actions in order to preserve and protect the Debtor’s estate and reorganization prospects. Not only may the outcome of the [creditors’] Actions affect the administration of this case, but the possibility of inconsistent judgments warrants the issuance of an injunction . . . .

*Id.* at 802. *See also In re Singer Co. N.V.*, 2000 WL 33716976, at \*7.

Akin to the claims the debtor’s investors asserted in *Fox, Stahl, Apostolou*, and *AP Industries*, the claims at issue in the Settlement are so inextricably intertwined and related to the underlying SIPA proceeding and the Trustee’s Merkin Action that it is clear that the Settlement will impair this Court’s jurisdiction over this proceeding and the Trustee’s ability to marshal assets on behalf of the estate. As in the foregoing cases, the Settlement will result in a “greater distribution on a first come, first serve basis from assets which the trustee has standing to

recover . . . .” *In re Keene Corp.*, 164 B.R. at 854. The investors in the Merkin Funds must “wait their turn behind the trustee . . . .” *Apostolou*, 155 F.3d at 881.

Moreover, allowing the Settlement to go forward could create confusion among other BLMIS investors and creditors who may feel compelled to initiate their own self-help proceedings and which could create a more widespread “race to the courthouse” environment, threatening the orderly administration of the estate. The statutory schemes created by SIPA and the Bankruptcy Code are specifically aimed at avoiding such a result. *See Sec. Inv. Prot. Corp. v. Blinder, Robinson & Co.*, 962 F.2d 960, 965 (10th Cir. 1992) (SIPA “establishes procedures for the prompt and orderly liquidation of SIPC members”) (internal citations and quotations omitted); *see also In re Shea & Gould*, 214 B.R. 739, 750 (Bankr. S.D.N.Y. 1993) (Bankruptcy Code seeks to prevent “race to the courthouse”); *In re Rubin*, 160 B.R. 269, 281 (Bankr. S.D.N.Y. 1993) (same); *Gross v. Russo (In re Russo)*, 18 B.R. 257, 265 (Bankr. E.D.N.Y. 1982) (same).

**C. The Settlement Threatens to Undermine the Claims Administration Process and This Court’s Jurisdiction Under SIPA and the Bankruptcy Code**

This Court already has approved a claims process and determined how customers’ and other creditors’ claims are to be valued and administered. The Settlement consists of a complex system, whereby the Receivers will direct settlement payments to select investors depending on a determination of whether such investors were aware of Merkin’s delegation of authority to Madoff: According to the NYAG Press Release, “[d]epending on the size of their losses, eligible investors will be entitled to receive over 40 percent of their cash losses. *Pursuant to a claims process*, investors who were not aware of Merkin’s delegation to Madoff will receive a defined percentage of their losses, while those who were aware of Madoff’s role will be eligible to receive a smaller recovery.” (*See Powers Decl. Ex. A (emphasis added)*). The NYAG further

stated that the select investors who would benefit from the Settlement, “are likely to receive additional payments at a future date when the Madoff Estate is able to distribute moneys recovered by Irving Picard . . . .” (*See id.*)

The duplicative and undoubtedly expensive claims process contemplated by the Settlement circumvents the claims determination and allowance process authorized by this Court, in which all of the beneficiaries of the Settlement are direct or indirect participants. The beneficiaries of the Settlement would thus leapfrog over customers and take for themselves funds that otherwise would be recoverable by the Trustee and distributed to customers and creditors of BLMIS in accordance with this Court’s Net Equity Decision and Customers Decision. Net Equity Decision, 424 B.R. 122; Customers Decision, 454 B.R. 285. In this regard, the Settlement would accomplish indirectly what is prohibited directly—indirect investors who are not customers will recover on their claims stemming from their investments with the Merkin Funds out of property fraudulently transferred from BLMIS to the Merkin Defendants and the Merkin Funds, all to the exclusion of judicially recognized customers and claimants. Both this Court and the District Court have, in granting and affirming the injunction at issue in *Fox*, stated that the potential for distributions outside of “the plan that was determined by the Net Equity Decision” was “particularly alarming.” *See Fox*, 2012 WL 990829 at \*14; *Fox*, 429 B.R. at 437.

The Merkin Funds have all filed claims in the liquidation and are participating in the claims process in place before this Court. (*See Cohen Aff. Exs. A–C.*) In addition, the Settlement purports, among other things, to provide a recovery for the losses of investors in the Merkin Funds. By seeking to tap into the same pool of money as the Trustee before the conclusion of the Trustee’s Merkin Action, the Third Party Actions threaten the administration of the BLMIS estate and should be enjoined.

The Settlement likewise threatens to interfere with the jurisdiction of this Court by giving a New York State court jurisdiction over the Settlement and its claims process. According to the NYAG Press Release, the New York State court is to retain continuing jurisdiction over the claims process contemplated by the Settlement, giving that court jurisdiction over distributions of potential estate property. This effort infringes on the Court's jurisdiction under the Bankruptcy Code and SIPA § 78eee(b)(2)(A), which provides for exclusive jurisdiction over the debtor's property wherever located.

**D. The Merkin Defendants Must Be Enjoined From Dissipating Their Assets Until the Trustee's Merkin Action Has Concluded**

This Court also should enjoin the Merkin Defendants from paying any additional Settlement monies or otherwise distributing or pledging their assets until the Trustee's litigation has concluded. A section 105(a) injunction is further appropriate to enjoin the distribution of assets by a party "when those assets may be subject to . . . recovery" by the estate. 2 COLLIER ON BANKRUPTCY ¶ 105.04[5][a] (16th ed. 2010); *see also Unsecured Creditors' Comm. of DeLorean Motor Co. v. DeLorean (In re DeLorean Motor Co.)*, 755 F.2d 1223, 1227–31 (6th Cir. 1985); *O'Donnell v. Royal Bus. Grp., Inc. (In re Oxford Homes, Inc.)*, 180 B.R. 1, 13 (Bankr. D. Me. 1995). Courts have done so when presented with evidence that the assets at issue would imminently be disposed of, *In re DeLorean Motor Co.*, 755 F.2d at 1225, or where the assets are cash or cash equivalents, which are "highly susceptible to diversion and loss." *In re Oxford Homes, Inc.*, 180 B.R. at 13. Under such circumstances, "it is appropriate and, in a given case may be necessary, that the court issue a form of provisional order, injunctive or otherwise, to ensure that a judgment ordering their return will be meaningful." *Id.* (citing *In re DeLorean Motor Co.*, 755 F.2d at 1230). Moreover, the moving party need not conclusively establish that the assets in question are property of the estate; a showing that there is a "reasonable possibility"

that such assets may be property of the estate may be sufficient. *In re DeLorean Motor Co.*, 755 F.2d at 1230.

Based on the information available to the Trustee, a substantial portion of the assets currently held by the Merkin Defendants consists of fraudulently transferred estate property received by these Defendants from BLMIS. (Powers Decl. ¶ 4 n.2.) The Merkin Defendants already have settled three actions and at least two of the third party arbitrations have resulted in a confirmed arbitration award. (*See* Powers Decl. ¶ 8; Ex. L at 2–3.) And the NYAG has now entered into a Settlement that threatens to deplete substantially all, if not all, of Merkin’s assets. The risk of dissipation is heightened by the Trustee’s belief that nearly \$200 million is currently held in escrow by BNY Mellon N.A., as escrow agent, pending resolution of the NYAG Action. (*See* Powers Decl. ¶ 8.) Because the dissipation of assets that may be recovered by the estate are in imminent danger of being dissipated, this Court should enjoin the Merkin Defendants from paying any additional settlement monies or otherwise distributing or pledging their assets until the Trustee’s Merkin Action has concluded.

**CONCLUSION**

For the foregoing reasons, the Trustee respectfully requests that the Court enforce the automatic stay, SIPA, and Stay Orders of the District Court, otherwise preliminarily enjoin the Defendants from depleting the Merkin Defendants’ assets pending the completion of the Trustee’s Merkin Action and compel the Defendants to produce the Settlement Agreement to the Trustee, SIPC, and the Court, by issuing an order in the form attached hereto as Exhibit A.

Date: New York, New York  
August 1, 2012

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# **EXHIBIT C**

# Practice & Procedure

BY JAMES W. DAY AND MARC E. HIRSCHFIELD<sup>1</sup>

## The *Barton* Doctrine: Still Kicking after 130 Years

For most of the 130 years since the U.S. Supreme Court issued its ruling in *Barton v. Barbour*,<sup>2</sup> it has been a relatively uncontroversial principle of bankruptcy law that a party seeking to sue a court-appointed receiver (or in later years, a bankruptcy trustee) must first seek leave of the appointing court before filing its complaint or claim for relief. This principle (known as the “*Barton doctrine*”) was revisited and reaffirmed recently in *In re VistaCare Group LLC*,<sup>3</sup> wherein a disgruntled purchaser of real estate sought leave to sue a bankruptcy trustee in state court on claims related to actions that the trustee took in his official capacity. By rejecting the bankruptcy court’s assertion that the *Barton* doctrine was no longer applicable, the U.S. Court of Appeals for the Third Circuit issued a reminder to bankruptcy and receivership practitioners (and those who may wish to sue them) that the *Barton* doctrine is as relevant today as when it was first formally articulated in 1881.

### *Barton* and Railroad Receiverships

What is known today as the *Barton* doctrine has earlier roots in an 1872 U.S. Supreme Court case, *Davis v. Gray*,<sup>4</sup> a breach-of-contract case between the appointed receiver for the Memphis, El Paso and Pacific Railroad Company and the governor of the state of Texas. The state of Texas allegedly reneged on an option contract to purchase land needed to build the railroad when it sold parcels of the contracted land to families who had been “squatting” on those reserves.<sup>5</sup> The receiver brought a lawsuit alleging that the railroad’s charter was a contract between the state and the company, and that Texas had passed a law impairing its obligation on this contract when the state amended its constitution in a manner that allowed the land sale to go forward to persons other than the company.<sup>6</sup> The defendants demurred on several grounds, including that the receiver did not have authority to sue Texas officials in their respective official or individual capacities.<sup>7</sup> The Supreme Court upheld the receiver’s right to bring the lawsuit, stating that “[a] receiver is appointed upon a principle of justice for the benefit of all concerned.... The court will not allow him to

be sued touching the property in his charge, nor for any malfeasance as to the parties, or others, without its consent; nor will it permit his possession to be disturbed by force, nor violence to be offered to his person while in the discharge of his official duties.”<sup>8</sup>

This language would be referenced nine years later in *Barton v. Barbour*. Like *Davis*, *Barton* was also a railroad receivership case; however, in *Barton* the receiver was the defendant rather than the plaintiff. Frances H. Barton, a sleeping-car passenger on a railway operated by the Washington City, Virginia Midland and Great Southern Railroad Company (a railroad that would eventually become a part of today’s Norfolk Southern Railway), was “thrown from the track” and thrown down an embankment.<sup>9</sup> Without first seeking leave of the court that appointed him, Barton sued John S. Barbour in the Supreme Court of the District of Columbia in his capacity as receiver of the railroad, alleging that the injuries she sustained resulted from a defect in the rails upon which she was traveling.<sup>10</sup> The District of Columbia court dismissed Barton’s complaint on the basis of lack of jurisdiction, pointing to her failure to obtain leave of the court that had appointed Barbour (Virginia’s Circuit Court for the city of Alexandria) prior to bringing her suit.<sup>11</sup>

Barton appealed to the Supreme Court, arguing that the only consequence resulting from prosecuting a suit against a receiver without leave of the appointing court was a finding of contempt or injunctive relief rather than dismissal, and that leave was not required in suits that did not attempt to reclaim property in the receiver’s hands.<sup>12</sup> The Court disagreed, and instead affirmed the District of Columbia court’s dismissal of Barton’s suit, citing *Davis* for the general rule that “before [a] suit is brought against a receiver leave of the court by which he was appointed must be obtained.”<sup>13</sup> Rather than adopting the narrow interpretation of the rule urged by Barton, the Supreme Court found the prohibition to apply to any suit against a receiver for a money demand. The Court’s reasoning for such an expansive rule continues to be cited today: “The evident purpose of a suitor who brings his action against a receiver without leave is to obtain some advantage over the other claimants upon the assets



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<sup>1</sup> The views expressed herein are solely those of the authors.

<sup>2</sup> *Barton v. Barbour*, 104 U.S. 126 (1881).

<sup>3</sup> *In re VistaCare Group LLC*, 678 F.3d 218 (3d Cir. 2012).

<sup>4</sup> See *Davis v. Gray*, 83 U.S. 203 (1872).

<sup>5</sup> *Id.* at 209-10.

<sup>6</sup> *Id.* at 210-11.

<sup>7</sup> *Id.* at 213-15.

<sup>8</sup> *Id.* at 218 (citing *De Groot v. Jay*, 30 Barb. 483 (N.Y.S. 1859), and collecting cases).

<sup>9</sup> *Barton v. Barbour*, 104 U.S. 126, 127 (1881).

<sup>10</sup> *Id.* at 127.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 129-30.

<sup>13</sup> *Id.* at 128.

in the receiver's hands.<sup>14</sup> Citing British common law, the Court explained that given that a money judgment against a receiver would be satisfied by the assets of a receivership estate, there was no practical difference between a suit against a receiver's property and a suit to obtain judgment for a money demand.<sup>15</sup>

The *Barton* Court continued to illustrate the problems that might arise if litigants such as Barton were allowed to sue receivers such as Barbour without leave of the appointing court: Tort claims could theoretically receive equal or even greater priority than administrative obligations incurred by the receiver in the ordinary course of business because the other courts in which such claims might be brought would arrive at their determinations of liability without reference to other creditors.<sup>16</sup> The Court thus primarily concerned itself with the need to centralize control over the assets of a receivership estate in one court so as to avoid the kind of chaotic piecemeal liquidation/claims resolution process that receiverships (and, later, the Bankruptcy Code) were intended to avoid. The Supreme Court held that the District of Columbia lacked jurisdiction to entertain Barton's tort claim unless and until leave was obtained from the court that appointed the receiver.<sup>17</sup>

### Dissent Gives Rise to Statutory Exception

In dissent, Justice Miller noted that the rule announced in *Barton* left open the possibility that receivers managing operational businesses could conduct their affairs without regard to state and local laws, confident that they would be shielded from liability at least temporarily by the jurisdiction of the court that had appointed them.<sup>18</sup> Should the appointing receivership court decide to exercise jurisdiction over the claim over which a plaintiff sought leave to sue a receiver, the plaintiff could be denied his or her right to trial by jury.<sup>19</sup> This concern was addressed six years later with the passage of 28 U.S.C. § 959(a), which created an exception to the *Barton* doctrine by permitting trustees, receivers and managers of property to be sued without leave of the court that appointed them "with respect to any of their acts or transactions in carrying on business connected with such property."<sup>20</sup> The statute also protects the right of litigants to trial by jury.<sup>21</sup>

Circuit courts have since consistently drawn a negative inference from the passage of § 959(a), reasoning that the statute's enactment essentially codified those aspects of the *Barton* decision that the statute did not overturn.<sup>22</sup> Prior to the Third Circuit's decision in *VistaCare* and in addition to the Sixth and Ninth circuits, five other circuit courts had held that the *Barton* doctrine applies not just to equity receivers but to bankruptcy trustees, as well.<sup>23</sup> The U.S. Courts of Appeals for

the Fourth, Eighth, Tenth and District of Columbia Circuits have not yet considered the applicability of the *Barton* doctrine in a precedential opinion.<sup>24</sup> However, because suits in the appointing bankruptcy court do not threaten the bankruptcy court's *in rem* jurisdiction over property of the debtor's estate, these rulings do not prevent a bankruptcy trustee from being sued without leave in the appointing bankruptcy court itself.<sup>25</sup>

### In re VistaCare Group LLC

**William Schwab**, the chapter 7 trustee of VistaCare Group LLC, was appointed to administer a bankruptcy estate that included a 12-acre parcel of land in southeastern Pennsylvania that had been subdivided into 45 lots.<sup>26</sup> A retirement home stood on the first of those lots; the remaining 44 lots were subdivided and zoned for mobile homes.<sup>27</sup> A subdivision plan approved by the local township and governing the 12-acre parcel prohibited the sale of the mobile home lots to the mobile home owners.<sup>28</sup> At an auction, the trustee sold the lot upon which the retirement home was built, but determined that the lots containing the mobile homes also needed to be liquidated, zoning restrictions notwithstanding.<sup>29</sup> Without approval from the purchaser of the retirement home, Schwab entered into an agreement with the township to abrogate the zoning restriction.<sup>30</sup>

Seven months later, the purchaser of the retirement home filed a motion in bankruptcy court for leave to file suit against the trustee in state court, alleging that the agreement between the trustee and the township abrogating the zoning restriction deprived the purchaser of its property rights without notice and without due process of law, and that the sale of the remaining lots to the mobile home owners damaged the purchaser's property interest.<sup>31</sup> The trustee argued that the *Barton* doctrine prohibited a suit in state court without permission of the bankruptcy court, and that the bankruptcy court should refuse to grant such permission in light of the nature of the purchaser's claims and the trustee's affirmative defenses to those claims.<sup>32</sup>

Following a hearing on the motion, the bankruptcy court expressed doubt that the purchaser needed its permission to file suit against the trustee, stating that the *Barton* doctrine was "antiquated and probably not controlling in the Third Circuit."<sup>33</sup> The court issued an order granting the purchaser's motion for leave to commence a lawsuit in state court against the trustee.<sup>34</sup> The district court affirmed the bankruptcy court's decision, and the trustee appealed the matter to the Third Circuit Court of Appeals.

The Third Circuit affirmed the district court's decision, but explicitly rejected the bankruptcy court's skepticism with respect to the applicability of the *Barton* doctrine.<sup>35</sup> The

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 128-29.

<sup>16</sup> *Id.* at 130. The Court stated that "[i]f a passenger on the railroad, who is injured in person or property by the negligence of the servants of the receiver, can, without leave, sue him to recover his damages, then every conductor, engineer, brakeman or track-hand can also sue for his wages without leave. To admit such a practice would be to allow the charges and expenses of the administration of a trust property in the hands of a court of equity to be controlled by other courts, at the instance of impatient suitors, without regard to the equities of other claimants, and to permit the trust property to be wasted in the costs of unnecessary litigation."

<sup>17</sup> *Id.* at 136-37.

<sup>18</sup> *Id.* at 137-38.

<sup>19</sup> *Id.* at 140.

<sup>20</sup> 28 U.S.C. § 959(a).

<sup>21</sup> *See id.*

<sup>22</sup> *See, e.g., In re DeLorean Motor Co.*, 991 F.2d 1236 (6th Cir. 1993); *In re Crown Vantage Inc.*, 421 F.3d 963 (9th Cir. 2005).

<sup>23</sup> *See, e.g., Muratore v. Darr*, 375 F.3d 140, 143 (1st Cir. 2004); *In re Lehal Realty Assocs.*, 101 F.3d 272, 276 (2d Cir.1996); *Anderson v. United States*, 520 F.2d 1027, 1029 (5th Cir. 1975); *In re Linton*, 136 F.3d 544, 546 (7th Cir.1998); *Lawrence v. Goldberg*, 573 F.3d 1265, 1269 (11th Cir. 2009).

<sup>24</sup> *VistaCare*, 678 F.3d 218 at n.2.

<sup>25</sup> *See generally Crown Vantage*, 421 F.3d at 971 ("The requirement of uniform application of bankruptcy law dictates that all legal proceedings that affect the administration of the bankruptcy estate be brought either in bankruptcy court or with leave of the bankruptcy court.")

<sup>26</sup> *Id.* at 222.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 222-23.

<sup>29</sup> *Id.* at 223.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 224-25.

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## Practice & Procedure: Barton Doctrine Still Kicking after 130 Years

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Third Circuit held that under the *Barton* doctrine, leave of the bankruptcy court was required before an action could be commenced against a bankruptcy trustee.<sup>36</sup> Because the purchaser had sought leave from the bankruptcy court prior to suing the trustee, the purchaser had complied with the *Barton* doctrine; therefore, the district court had correctly ruled that the bankruptcy court's decision to grant leave was proper.<sup>37</sup> Because VistaCare was not in the business of buying and selling real estate, the purchaser's suit against the trustee was not related to carrying on VistaCare's business and therefore the exception found in § 959(a) did not apply.<sup>38</sup>

The *VistaCare* court embarked on a thorough review of the history and development of the *Barton* doctrine in reaching its conclusion that the doctrine is still applicable. The court noted that unless the *Barton* doctrine was enforced, parties bringing suit against trustees would be able to obtain an advantage over other claimants as to the distribution of the assets in the trustee's hands by attempting to enforce their judgment in outside jurisdictions.<sup>39</sup> The trustee's actions on behalf of the estate and the estate's creditors would likely be impeded if the trustee was required to defend against suits in other courts.<sup>40</sup> The court also emphasized that the *Barton* doctrine was not abrogated by the fact that bankruptcy trustees are no longer appointed by the bankruptcy court but are instead appointed by the U.S. Trustee because bankruptcy trustees are administering property that has come under the bankruptcy court's control, and because bankruptcy trustees

can be removed by the court for cause.<sup>41</sup> The court declined to draw the inference urged by the plaintiff that because 11 U.S.C. § 323(b) provides a bankruptcy trustee with "capacity to sue and be sued," yet mentions no leave-of-court requirement, no such requirement exists.<sup>42</sup> The *VistaCare* court even went so far as to criticize the bankruptcy court's opinion in an earlier case in which the court concluded that the Bankruptcy Code had superceded the common law *Barton* doctrine, clarifying that in the Third Circuit "the *Barton* doctrine has continued validity."<sup>43</sup>

### Barton Doctrine Remains Relevant Today

The *Barton* doctrine has proven itself useful by allowing bankruptcy and receivership courts to efficiently administer assets of the estate to maximize value for creditors by centralizing control over those assets. The doctrine has also been applied extraterritorially, thereby preventing "forum-shopping" in the adjudication of claims belonging to the estate in jurisdictions outside of the U.S.<sup>44</sup> In at least one circuit, the doctrine has also been expanded to include suits against creditors functioning as the equivalent of court-appointed officers.<sup>45</sup> The Third Circuit's *VistaCare* decision is only the most recent in an as-yet-unbroken line of circuit court opinions reminding practitioners to consider the *Barton* doctrine prior to bringing suit against a bankruptcy trustee or court-appointed receiver. **abi**

36 *Id.*

37 *Id.* at 232.

38 *Id.* at n. 5.

39 *Id.* at 224-25.

40 *Id.* at 230.

41 *Id.* at 229-30.

42 *Id.* at 231.

43 *Id.* at 228-29.

44 See *Smith v. Ace Ins. Co. (In re BCE West LP)*, 2006 U.S. Dist. LEXIS 62772 \*15-16 (D. Ariz. 2006); *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 460 B.R. 106, 116 (Bankr. S.D.N.Y. 2011), *aff'd*, 2012 U.S. Dist. LEXIS 63508 (S.D.N.Y. 2012).

45 See *Lawrence v. Goldberg*, 573 F.3d 1265, 1270 (11th Cir. 2009) (citing *Carter v. Rodgers*, 220 F.3d 1249, 1252 (11th Cir. 2000)).

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# **EXHIBIT D**

SUPREME COURT OF THE STATE OF NEW YORK  
 COUNTY OF NEW YORK

----- X	
BART M. SCHWARTZ, as Receiver for ARIEL	:
FUND LIMITED and for GABRIEL CAPITAL, L.P.,	:
	Index No.:
Plaintiff,	:
	<b><u>COMPLAINT</u></b>
- against -	:
	:
J. EZRA MERKIN and GABRIEL CAPITAL CORP.,	:
	:
Defendants.	:
----- X	

Plaintiff Bart M. Schwartz, the Court-appointed Receiver for Ariel Fund Limited (“Ariel Fund”) and Gabriel Capital, L.P. (“Gabriel Fund,” and together with Ariel Fund, the “Funds”), as and for his complaint against J. Ezra Merkin (“Merkin”) and Gabriel Capital Corporation (“GCC” and together with Merkin, the “Defendants”), respectfully alleges as follows:

**NATURE OF THE ACTION**

1. The Funds are pooled investment vehicles that are private investment funds, popularly known as “hedge funds.” They entrusted the assets of their investors to Merkin and GCC, the Funds’ investment advisor, on the basis that Merkin would oversee the Funds’ investments in the distressed debt space, an area in which he purported to be an expert. In addition, Merkin promised that he would have “ultimate responsibility for the management, operations and investment decisions” made on behalf of the Funds. In return, Merkin and GCC collected substantial fees for their services – fees much higher than those charged by managers of mutual funds or other financial advisors at institutions.

2. It turned out, however, that rather than make any decisions concerning the Funds' investments, Merkin instead handed over that responsibility to Cerberus Capital Management, L.P. ("Cerberus") with respect to approximately 65% of the Funds' assets.

3. Compounding this, while claiming that the Funds invested in distressed debt opportunities under his supervision and management, Merkin secretly turned over responsibility for almost the entire remainder of the Funds' assets to Bernard L. Madoff ("Madoff") and his company, Bernard L. Madoff Investment Securities, LLC ("BLMIS"), even though Madoff's and BLMIS' investment strategies were entirely inconsistent with those of the Funds and had nothing to do with distressed investments.

4. Merkin's decision to hand over almost all of the Funds' assets to Cerberus and Madoff was in direct contravention to the Funds' stated policies and investment objectives, and in direct violation of the Funds' internal limitations adopted to ensure diversification and risk management.

5. Cognizant that the Madoff investment was inconsistent with the investment strategy of the Funds as articulated in the Funds' offering documents, Merkin and GCC went to great lengths to conceal this investment from the Funds' investors. Indeed, Madoff's name and a description of his "split-strike conversion" investment strategy were never listed in any of the reports prepared by Merkin and GCC and disseminated to the Funds' investors. Nor did Merkin and GCC cause any such information to be included in the Funds' offering documents. In fact, the Funds' offering documents, the preparation of which was a primary responsibility of Merkin and GCC, did not even list Madoff as a broker dealer or custodian for the Funds.

6. These omissions were intentional, because Merkin and GCC knew very well how to describe the role and investment strategy of Madoff. They did so in connection with the offering of another family of private investment funds, Ascot Fund Limited and Ascot Partners, LP (together, "Ascot"), which funds also were managed by Merkin and GCC and which were fully invested in Madoff. In Ascot's offering document, Merkin described Madoff's putative investment strategy, the so-called "split-strike conversion strategy," and also identified BLMIS' role as a broker for the fund. None of these or any similar disclosures appear in the Funds' offering documents.

7. The reason why Merkin and GCC went to great lengths to hide Madoff's role in the Funds is a simple one. Merkin and GCC completely ignored their duties and acted with reckless disregard for the investors in the Funds because they were solely motivated by the substantial fees they were collecting for so doing. Throughout the years, as a result of simply feeding monies to Madoff and Cerberus, and despite essentially doing nothing to exercise his duties to the Funds, Merkin collected (directly or through his sole ownership of GCC) more than \$300 million in unwarranted management and incentive fees.

8. Violating and breaching his investment mandate was not all the harm that Merkin did. He continued to fail his clients, the Funds and their investors by failing both to monitor these investments properly and to supervise the activities of Madoff.

9. Likewise, with respect to the Cerberus investment, Merkin never disclosed that 65% of the Funds' assets were sent to another investment group with which Merkin split the fees. Instead, Merkin presented all such investments as though they were self-sourced. These intentional misrepresentations assisted Merkin in creating an "investment guru persona" for

himself and opened the door to many investors who would have never invested with Merkin had they known the truth.

10. Had Merkin and GCC disclosed the Madoff investment, which was inconsistent with the Funds' stated investment strategy, or the level of exposure to the Cerberus investments, which was inconsistent with the Funds' stated policies and investment objective, the Funds' investors would have taken affirmative steps to remove Merkin and GCC from managing the Funds, sought the wind-down of the Funds, demanded termination of said investments, or redeemed their interests in the Funds. In fact, investors took such steps when the truth finally emerged.

11. Following Madoff's collapse, Merkin and GCC were obliged for the first time to report a shocking loss of about a third of the Funds' value. The loss was shocking because: (i) any relationship of the Funds to Madoff was previously hidden; (ii) Madoff's strategy did not fit in the Funds' investment objective of distressed investments; and (iii) the size of the investment with Madoff exceeded the Funds' risk and diversification parameters.

12. Moreover, due to further scrutiny by investors, Merkin was forced to report that the vast majority of the remaining portfolio was also entrusted in the hands of Cerberus, concentrating the investments of the Funds in a handful of outside money managers and completely eradicating any rationale for Merkin's existence and fees. These disclosures ultimately led to the appointment of Plaintiff as Receiver for the Funds.

13. In sum, Merkin was not an investment guru, but, instead, nothing more than a glorified, albeit undisclosed, marketer for Cerberus and Madoff. That was not what his role was supposed to be or why he collected the fees that he did from the Funds.

14. The Funds are now seeking to recoup the losses they incurred as a result of Defendants' willful and reckless conduct, conduct that was fraudulent and in violation of their contractual, fiduciary and other duties to the Funds, and also to recover the exorbitant fees paid to the Defendants and other damages as described below.

#### **PARTIES**

15. Plaintiff, Bart M. Schwartz, is the Court-appointed Receiver for the Funds pursuant to a Stipulation and Order Appointing Receiver dated June 10, 2009 (the "Receivership Order"), which was entered by the Supreme Court of the State of New York, New York County in *The People of the State of New York (Plaintiff) against J. Ezra Merkin and Gabriel Capital Corporation (Defendants), and Ariel Fund Limited, et al.* (Relief Defendants), Index No. 450879/2009. A true and correct copy of the Receivership Order is attached hereto as Exhibit A. The Receivership Order, by its terms, supersedes a prior Order, dated May 28, 2009, which was entered on the Supreme Court's docket on or about June 1, 2009.

16. Ariel Fund is an offshore exempted company incorporated under the laws of the Cayman Islands, with its principal place of business in the Cayman Islands. The registered office of Ariel Fund is c/o M&C Corporate Services Limited, Uglan House, South Church Street, George Town, Grand Cayman, Cayman Islands. Participation in Ariel Fund was offered via a Confidential Offering Memorandum or offering circular that was amended from time to time. Ariel Fund was set up for foreign investors and for U.S. tax-exempt institutions.

17. Gabriel Fund is a Delaware limited partnership that was formed in August 1991, with its principal place of business at 450 Park Avenue, New York, New York. Gabriel Fund

was organized to operate primarily as a private investment partnership for the benefit of U.S. taxable investors.

18. Defendant Merkin is an individual residing at 740 Park Avenue, New York, New York, and with a business office at 450 Park Avenue, New York, New York. Merkin is the general partner of Gabriel Fund and the sole shareholder and sole director of defendant GCC, the investment advisor of Ariel Fund. Merkin is also the former chairman of General Motors Acceptance Corporation (“GMAC”).

19. Defendant GCC is a Delaware corporation, with its principal place of business at 450 Park Avenue, New York, New York. GCC, as directed and managed by Merkin, served as the investment advisor of Ariel Fund. GCC also provided administrative and other managerial services to Gabriel Fund.

### **JURISDICTION AND VENUE**

20. Defendants are subject to personal jurisdiction under CPLR §§ 301 and 302. Defendants reside, conduct or conducted business within the State of New York. Further, Merkin and GCC both maintain their principal place of business in New York.

21. Venue is proper in this county pursuant to CPLR § 503(a) and (c), and § 509.

### **FACTUAL ALLEGATIONS**

#### **I. BACKGROUND**

##### **A. Merkin, GCC and Their Relationship With the Funds**

22. Merkin created Ariel Fund in 1988 and Gabriel Fund (known at first as Ariel Capital, L.P.) in 1991. As of the end of the third quarter of 2008, Gabriel Fund had nearly 200

investors with a total of \$1.4 billion under management, while Ariel Fund had some 78 investors with a total of \$1.3 billion under management.

23. Merkin was the general partner of Gabriel Fund and also the sole shareholder and director of GCC, which served as the investment advisor for Ariel Fund. Merkin was responsible for all investment decisions concerning the Funds. The investment strategy of Ariel Fund closely mirrored that of Gabriel Fund.

24. In these capacities, Merkin had fiduciary responsibilities for oversight of the Funds' portfolios. Merkin and GCC reaped annual management fees equal to 1% of the capital invested in each of Ariel Fund and Gabriel Fund. In addition, Merkin and GCC collected an annual incentive fee of 20% of any appreciation in the assets of the Funds. As if such fees were not sufficient, the Funds were also responsible for various operating expenses of Merkin and GCC, including rent and salaries of personnel. Such additional expenses were in addition to the 1% management fee.

**B. The Funds' Investment Strategy**

25. The Funds were organized as vehicles for investing in distressed debt and bankruptcy-related securities. Their assets were to be principally managed by Merkin, who claimed expertise in these areas by reason of his tenure with GMAC.

26. GCC agreed to serve as investment advisor to Ariel Fund pursuant to, *inter alia*, the Seventh Amended and Restated Investment Advisory Agreement, dated December 29, 2008 (the "Ariel Fund Investment Advisory Agreement"). A true and correct copy of the Ariel Fund Investment Advisory Agreement is attached hereto as Exhibit B. Under this agreement, Merkin alone, as the sole director of GCC, was fully responsible for supervising, managing and directing

the investment of Ariel Fund's assets, in a manner consistent with the overall strategy of Ariel Fund. Ex. B at 7.

27. Likewise, as the general partner of Gabriel Fund, Merkin agreed to direct the investments of Gabriel Fund pursuant to the Fourth Amended and Restated Limited Partnership Agreement, dated April 1, 2006 (the "Gabriel Fund Partnership Agreement"). A true and correct copy of the Gabriel Fund Partnership Agreement is attached hereto as Exhibit C. Under this agreement, Merkin was required to "manage and control the affairs of [Gabriel Fund] to the best of his ability" and "use his best efforts to carry out the business and purpose of [Gabriel Fund]." Ex. C at 14.

28. The Offering Memoranda for the Funds detailed their investment strategies and goals, and further highlighted Merkin's supposed accountability for each. True and correct copies of the Confidential Offering Memorandum for Ariel Fund, dated March 2006 (the "Offering Memorandum for Ariel Fund") and the Confidential Offering Memorandum for Gabriel Fund, dated March 2006 (the "Offering Memorandum for Gabriel Fund", and together with the Offering Memorandum for Ariel Fund, the "Offering Memoranda"), are attached hereto as Exhibit D and Exhibit E, respectively.

29. Thus, the Offering Memorandum for Ariel Fund, dated March 2006, outlined a purported investment strategy as follows:

The Fund's investment objective is to provide shareholders with a total return on their investment consisting of capital appreciation and income by investing in a diverse portfolio of securities. Generally, the Fund will invest and trade in U.S. and non-U.S., marketable and non-marketable, equity and debt securities and options, as well as other evidences of ownership interest or indebtedness,

including receivership certificates, and promissory notes and payables to trade creditors of distressed companies or companies in Chapter 11 bankruptcy proceedings, and commodities contracts, futures contracts (relating to stock indices, options on stock indices, commodities and options on commodities) and forward contracts. The Fund will invest in the securities of corporations believed to be fundamentally undervalued. The Fund will also make indirect investments with third-party managers, including investments through managed accounts and investments in mutual funds, private investment partnerships, closed-end funds and other pooled investment vehicles which engage in similar investment strategies.... (See Ex. D at 20-21).

30. Substantially similar, if not identical, representations were made in the Offering Memorandum for Gabriel Fund, dated March 2006 (*see* Ex. E at 14-15), and were also found in the earlier versions of the Funds' offering documents.

31. The Offering Memoranda further detailed the Funds' investment strategy, stating that the Funds will "primarily engage in distressed and bankruptcy investing (including private equity investments) and risk and other arbitrage transactions (including capital structure arbitrage transactions)." *See* Ex. D at 21; Ex. E at 15. In supposed furtherance of that investment strategy, the Offering Memoranda represented that the Funds "expect[] to frequently use hedging devices and will engage in short sales." *See e.g.*, Ex. E at 15.

32. The Offering Memoranda also advised that the Funds did not use any self-clearing money managers.

33. While the Offering Memoranda acknowledge that Merkin could delegate investment discretion to outside money managers, any such delegation was expressly limited. For example, the Offering Memoranda state that:

- a. “[Merkin] may delegate investment discretion for all or a portion of the [Funds’] funds... to money managers, other than [Merkin], or make investments with Other Investment Entities. Although the Investment Advisor *will exercise reasonable care* in selecting such independent money managers or Other Investment Entities and *will monitor the results of those money managers* and Other Investment Entities, the Investment Advisor may not have custody over the funds invested with the other money managers or with Other Investment Entities.” Ex. D at 40-41; Ex. E at 28 (emphasis added); and
- b. Merkin was to “retain overall investment responsibility for the portfolio of the [Funds]” regardless of the Funds’ investment with third-party money managers or investment partnerships. *See* Ex. D at 20; Ex. E at 14.

34. The Offering Memoranda further set forth the allocation strategies for the Funds and represented that such strategies would not overly concentrate positions or investments. For example, they state that:

- a. The Funds “will not permit more than the greater of 50% of the [Funds’] capital and 25% of the [Funds’] total assets (on a cost basis, giving consideration to hedging techniques utilized) to be invested in a single investment.” Ex. D at 21; Ex. E at 15; and
- b. The Funds “will not permit more than 10% of the [Funds’] capital to be placed at risk in a single investment.” *Id.*

35. The Offering Memoranda also touted Merkin’s credentials and maintained that he would be personally involved in individual investment decisions for the Funds. For example, the Offering Memorandum for Gabriel Fund stated:

- a. “J. Ezra Merkin will serve as the General Partner of [Gabriel Fund]. The General Partner has ultimate responsibility for the management operations and investment decisions made on behalf of [the Fund].” Ex. E at 3; and

- b. that Merkin would “devote substantially his entire time and effort during normal business hours to the management of [Gabriel Fund] and other investment entities managed by [Merkin]....” Ex. E at 30.

36. Both Offering Memoranda further stated that Merkin “will attempt to assess risk in determining the nature and extent of the investment the Fund[s] will make in specific securities.” Ex. D at 32; Ex. E at 20. Finally, the Offering Memoranda stated that the “success of the Fund[s] depends primarily upon [Merkin].” Ex. D at 40; Ex. E at 28.

37. Indeed, the continued viability of the Funds was completely dependent upon Merkin’s ongoing involvement as investment advisor. The Articles of Association for Ariel Fund, dated December 22, 1988 (the “Ariel Fund Articles”), provide that the directors of Ariel Fund “shall appoint” as investment advisor to the Fund, “J. Ezra Merkin or an entity legally or beneficially owned as to 51% by J. Ezra Merkin...and may entrust to and confer upon the [i]nvestment [a]dviser so appointed the management of the investment and re-investment of the monies and assets of [Ariel Fund].” Ex. F at 6-7. A true and correct copy of the Ariel Fund Articles is attached hereto as Exhibit F. The Ariel Fund Articles further maintain that all shares of Ariel Fund “shall be redeemed in a prompt and orderly manner” “[i]n the event of; (i) the termination of the agreement with the [i]nvestment [a]dviser...; or (ii) the death of J. Ezra Merkin....” *Id.* at 25.

38. Similarly, the Gabriel Fund Partnership Agreement provides that “the withdrawal of [Merkin] will dissolve the [Gabriel] [p]artnership.” Ex. C at 17. As the Funds’ operating documents show, Merkin’s role was believed to be central to the overall viability of the Funds.

### C. The Merkin-Madoff Relationship

39. Merkin first met Madoff in the very late 1980s or early 1990s. By then, Madoff had founded his own brokerage and trading firm, BLMIS, and he was considered among the pioneers in electronic trading. Through the years, BLMIS had become a major market-maker for stocks and options enabling Madoff to obtain a strong public profile, which he used to set up and run a separate investment advisory business.

40. Upon information and belief, following the initial meeting between Merkin and Madoff, sometime in the early 1990s, Madoff described to Merkin his purported trading strategy with respect to his investment advisory business, known as a “split strike conversion” strategy. The strategy was to (i) buy stocks of corporations that were included in the blue-chip Standard & Poor’s 100 Index (the “Index”), and simultaneously (ii) buy put options below the current stock price to protect against large declines, and (iii) sell call options above the current price to fund the purchase of put options. The call options would also, to some degree, limit any gains that would be earned on the underlying stocks. Madoff claimed that under the right market conditions, he could achieve steady returns of over ten percent per year regardless of whether the market as a whole had advanced or declined. Nothing in the description of Madoff’s split-strike conversion strategy bears any similarity to distressed debt investing. But that aside, as the world is now well aware, his too-good-to-be-true scenario turned out to be just that.

41. In or about 2000, Merkin secretly began to allocate to Madoff a portion of the Funds’ assets to manage. Upon information and belief, Merkin subsequently increased the percentage of the Funds’ assets which he delegated to Madoff, such that by 2008 Madoff was improperly entrusted with more than 25% of the Funds’ total assets.

42. Madoff's description of his purported investment strategy evolved only slightly over time. He soon began to claim that he was using a larger "basket" of stocks selected from the Index, combined with put and call options on the Index itself rather than options on individual stocks. The positions were supposedly held for a short period of time lasting from a few days to no longer than about two months, and then liquidated. Madoff claimed to execute the "split strike conversion" strategy six to eight times per year. At some point, Madoff purportedly adopted the practice of exiting the market entirely at the very end of each quarter and putting all funds in U.S. Treasury bills ("Treasuries"). For this reason, BLMIS' quarterly statements to investors, and the end-of-year audits of investor holdings, would list only Treasuries. There was never any reference concerning any investments in distressed debt by Madoff.

43. In addition, Madoff did not charge any fees on the assets he managed for the Funds or on the returns he made on their behalf. As a result of Madoff's lower fee structure, the Funds' net asset values were higher, which, in the end, resulted in even more fees for Merkin and GCC -- fees in the hundreds of millions of dollars -- all unbeknownst to the Funds' investors.

44. The New York Attorney General, who moved quickly and decisively after Merkin's misconduct was discovered to support the freezing of his assets and to obtain the appointment of a receiver for the Funds -- but for which the Funds' and their investors could have been left with little practical remedy -- has also brought an action against Merkin and GCC. There, in a meticulous 139 paragraph amended complaint (the "NYAG Complaint"), the Attorney General detailed how Merkin and GCC hid from the Funds' investors the role and involvement of Madoff with the Funds. A true and correct copy of the NYAG Complaint is attached hereto as Exhibit G. The legal sufficiency of the amended complaint in this regard was

unequivocally upheld by the Court. *See The People of the State of New York (Plaintiff) v. J. Ezra Merkin and Gabriel Capital Corporation (Defendants), and Ariel Fund Limited, et al. (Relief Defendants)*, Index No. 450879/2009 (Feb. 17, 2010). The following excerpt from the NYAG Complaint is illustrative as to Merkin's conduct:

The fact that a significant portion of Ariel and Gabriel's assets were invested with Madoff was completely hidden from their investors, who believed that Ariel and Gabriel focused exclusively on investments in distressed debt and companies involved in bankruptcy or some other kind of restructuring such as a merger or a spinoff. During the course of its investigation, the office of the Attorney General interviewed half of the U.S. investors of Ariel and Gabriel. Of those interviewed, only one knew of the Madoff investment.

NYAG Complaint ¶ 68. Although it arises from many of the same operative facts, the instant Complaint, among other things, is making claims and seeking relief that may not be available in the Attorney General's action.

## II. THE MISCONDUCT OF MERKIN AND GCC

45. As investment advisor, Merkin and GCC owed the Funds a duty of care to ensure that the assets of the Funds were invested according to their stated goals and strategies, and a duty of vigilance to ensure that the assets were safeguarded. Merkin, and by extension, GCC, willfully or recklessly disregarded their duties as investment advisor to the Funds by improperly abdicating management responsibilities to Madoff and others.

46. Specifically, with respect to Madoff, Merkin failed to honor the obligations he owed to the Funds by, *inter alia*:

- a. permitting Madoff to manage and maintain custody over a significant portion of the Funds' assets when Merkin was obligated not to employ any self-clearing money managers. In fact, Madoff, a self-clearing money manager, managed, executed, and had custody of up to a third of the Funds' assets;
- b. allowing Madoff to invest a large portion of the Funds' assets in the supposed split-strike strategy when Merkin was obligated to utilize a diversified and sophisticated investment strategy that sought to capitalize on a wide range of opportunities including distressed debt, companies involved in bankruptcy proceedings, and mergers and acquisitions;
- c. conducting the Funds as classic feeder funds and passing a significant portion of the Funds' assets to Madoff, over which Merkin exercised little to no control, despite a duty to manage the Funds' portfolios actively;
- d. overly concentrating the Funds' investments with Madoff although Merkin was required to "not permit more than 10% of the [Fund's] capital to be placed at risk in a single investment." Ex. D at 21; Ex. E at 15; and
- e. performing minimal, if any at all, due diligence over Madoff and his organization, even though they were responsible for the management and custody of hundreds of millions dollars of the Funds' assets.

47. Separate and apart from this, Merkin entered into an agreement with Cerberus, which agreement Merkin concealed from the Funds, under which Cerberus would manage a large portion of the Funds' investments (the "Cerberus Account"). The Cerberus Account continues to exist to this day, and in recent years has held the majority of the Funds' assets. All due diligence, research, and trading decisions for the Cerberus Account were made by Cerberus – with little input from Merkin other than occasional conversations between Merkin and the principals of Cerberus. Cerberus also incurred millions of dollars in legal fees and other expenses in managing assets in the Cerberus Account, which Merkin reimbursed from the Funds' assets.

48. By mid-2002, almost one-third of Ariel Fund’s \$385,703,794 portfolio was invested with Madoff (\$125,089,730), and over 50% (\$203,947,900) with Cerberus. In 2002, Merkin also opened a managed account with fund manager Cohanzick Capital, L.P. (“Cohanzick”), which partially moved into Merkin’s offices. As of the end of 2002, over 80% of the Funds’ assets were managed by Cerberus, Madoff, and Cohanzick, and as of June 1, 2008, over 95% were so managed.

49. Thus, Merkin’s real (and concealed) role was not to manage the Funds but to market the Funds to investors and then determine how to allocate any new funds among the three active investments. As referenced in the Attorney General’s Complaint, the following table, shows the portion of Gabriel Fund’s assets allocated over time to the Madoff, Cerberus, and Cohanzick investments:

**Gabriel Capital, L.P. – Allocation of Assets to Outside Managers**

<u>Date</u>	<u>Total Equity (Long Value)</u>	<u>Madoff</u>	<u>Cerberus</u>	<u>Cohanzick</u>
12/31/2002	\$436,242,850.00	28.86%	48.06%	6.48%
12/31/2003	\$411,137,294.00	21.12%	49.06%	12.32%
12/31/2004	\$539,435,221.00	19.54%	59.44%	13.04%
12/31/2005	\$807,665,702.77	15.52%	59.58%	11.65%
12/31/2006	\$1,218,533,653.00	22.73%	56.56%	7.61%
12/31/2007	\$1,580,044,307.00	21.30%	61.72%	7.16%
06/01/2008	\$1,210,858,522.27	24.65%	62.59%	7.79%

NYAG Complaint ¶ 79. The allocations for Ariel Fund were substantially similar.

50. By so doing, Merkin continued to reap considerable management and investment advisory fees for supposedly actively managing the Funds’ portfolio when, in reality, he was improperly abdicating his management responsibilities to others.

51. On December 11, 2008, Madoff was arrested and charged with running a “Ponzi” scheme in violation of United States securities laws. The SEC also filed a civil complaint in the

United States District Court for the Southern District of New York seeking injunctive relief and to have BLMIS placed in receivership. *SEC v. Madoff*, 08 Civ 1079 (S.D.N.Y).

52. On February 20, 2009, during a public meeting with customers and creditors of BLMIS held in the United States Bankruptcy Court for the Southern District of New York, Irving Picard (the “Madoff Trustee”) reported that his investigation had revealed, among other things, that BLMIS had not traded or purchased any securities on the account of any customer (including the Funds) for at least the prior 13 years.

53. Subsequent to his February 20, 2009 report, the Madoff Trustee has represented in pleadings with the United States Bankruptcy Court that there are no records of BLMIS having cleared a single purchase or sale of securities at the Depository Trust Company or any other clearing and custody agency in which Madoff could reasonably have maintained positions. Nor has the Madoff Trustee found evidence that BLMIS ever purchased or sold any of the options that Madoff claimed to have purchased on customer statements. *See e.g., Picard v. Fairfield Sentry Limited, et al.*, Adv. Proc. No. 09-1239 (BRL) (Docket No. 1, Complaint 1 20).

54. Further, as noted, Madoff has admitted and pled guilty to, among other things, securities fraud violations for (i) not trading on the account of his investment advisory clients and (ii) running a Ponzi scheme since the 1990s.

55. By agreeing to take on principal management responsibility for the Funds’, Merkin was required to perform due diligence on, and monitor the performance of, all outside money managers to whom he entrusted the Funds’ assets.

56. At various times relevant hereto, there were a number of facts regarding Madoff which Merkin knew of or which, as a fiduciary, Merkin was obligated to know of and act upon, especially given the size of his investments for the Funds in Madoff, and the fact that he had not disclosed the existence, much less the size, of these to the Funds' investors.

57. As alleged in the NYAG Complaint, Merkin admitted in pre-trial testimony that he was aware of a number of people who were suspicious of the returns Madoff claimed to achieve, stating that "[t]here were over time persons who expressed skepticism about one or another aspect of the Madoff strategy or the Madoff return." *See* NYAG Complaint ¶ 107.

58. Further, the Madoff Trustee and/or the New York State Attorney General have alleged that at least three of Merkin's closest and most respected associates told Merkin repeatedly, throughout the time he invested with Madoff, that Madoff's returns were suspicious. These advisors were also troubled by Madoff's secrecy and other features of his money management business that were classic warning signs for fraud.

59. For example, Victor Teicher ("Teicher"), a money manager whom Merkin respected and trusted, advised Merkin against investing money with Madoff in the early 1990s, and repeated his views many times thereafter. Teicher believed that the combination of low volatility and high returns that Madoff reported was inconsistent with what could possibly take place in reality, and was therefore suspicious that the returns were not real. Upon information and belief, Teicher also told Merkin that he was troubled by the fact that Madoff's trade confirmations, rather than arriving on a daily basis for each day's trades, were sent several days later.

60. Additionally, concerns about Madoff’s strategy and returns grew within the investment community as a whole. In May 2001, Barron’s published an article discussing the remarkably steady returns purportedly achieved by Madoff. A true and correct copy of the Barron’s article is attached hereto as Exhibit H. MAR/Hedge published a similar article, entitled “*Madoff tops charts; skeptics ask how,*” the same month. A true and correct copy of the MAR/Hedge article is attached hereto as Exhibit I. The Barron’s article discussed the belief of many hedge fund professionals and options strategists that Madoff could not achieve the returns he reported — an average annual return of 15% for the preceding decade — using the strategy that Madoff described. In addition to the suspicious consistency of Madoff’s high returns, the article discussed several other warning signs that suggested Madoff might be committing fraud, including Madoff’s secrecy and the inability of “more than a dozen hedge fund professionals, including current and former Madoff traders” to duplicate Madoff’s returns using his strategy. *See* Ex. H at 2. As alleged in the Attorney General’s Complaint (NYAG Complaint ¶ 115), Merkin’s in-house counsel emailed Merkin a copy of the Barron’s article on May 6, 2001, (*see* Ex. H), and Merkin also had a copy of the MAR/Hedge article. Seven years later, Merkin still had copies of both of these articles in his files.

61. Both the Attorney General and the Madoff Trustee alleged that Merkin knew or should have known the following facts as well:

- a. that Madoff reported trades using paper trade confirmations sent to investors by mail, without providing any form of electronic real-time access, thus making it possible for Madoff to manufacture trade tickets reflecting near-perfect market timing;

- b. that Madoff maintained strict secrecy about his management of money entrusted to him;
- c. that Madoff consistently converted all holdings to Treasuries at the end of each quarter, a practice that, in light of Madoff's claim that his strategy depended on entering and exiting the market when the conditions were likely to render his strategy profitable, had no legitimate purpose other than to reduce transparency;
- d. the unusual long-term stability of Madoff's alleged returns, and that other sophisticated investors had themselves been unable to achieve those returns using Madoff's stated strategy;
- e. the identity of Madoff's accounting firm, and the fact that it was a small, relatively unknown accounting firm rather than a well-established, recognized audit firm; and
- f. that Madoff was self-clearing, that is, that he initiated and executed all trades and had custody of the securities he purchased, a failure to segregate responsibilities that increased the risk of fraud.

62. Based on these facts, and Merkin's response (or non-response) thereto, both the New York Attorney General and the Madoff Trustee have alleged that Merkin acted recklessly or with willful disregard for the duties he owed to the Funds, and if this is true, Merkin *per force* breached the fiduciary duties he owed to the Funds.

### III. MERKIN AND GCC IMPROPERLY COLLECTED ENORMOUS FEES

63. By the conduct described above (*see supra* ¶¶ 41-62), Merkin and GCC received substantial fees for little or no work.

64. Specifically, Madoff charged no management fee or incentive fee, and simply took a \$0.04 per share brokerage commission already built into the reported stock and option prices for Madoff's trades. Thus, for all of the Funds' assets that were Madoff-managed, Merkin

could keep the full 20% incentive fee, described in the investment management agreements with the Funds, in addition to the 1% management fee.

65. In contrast, Cerberus charged Merkin an annual management fee of 1% for the assets it managed, plus an annual incentive fee of 9% of profits. Cohanzick received an annual management fee of 1% plus an incentive fee of 10% less the current money market return. Thus, the assets given to Cerberus yielded Merkin only an 11% incentive fee after paying Cerberus's 9% fee, and Cohanzick even less.

66. Upon information and belief, Merkin's fees from 1989 through 2007 totaled approximately \$277 million from Gabriel Fund and approximately \$242 million from Ariel Fund.

67. The misconduct perpetrated by Merkin, as detailed herein, including improperly handing over the Funds' assets to Madoff and others and failing to disclose the Funds' investments with Madoff or Cerberus, was therefore committed for the exclusive benefit of Merkin, was entirely adverse to the interests of the Funds, and represented a total abandonment of Merkin's duties to act in the best interest of the Funds.

**COUNT I**  
**Breach of Fiduciary Duty**  
**(Against Merkin and GCC)**

68. Plaintiff repeats and re-allege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

69. Merkin and GCC, as the respective general partner and investment advisor for the Funds, owed the highest obligations and fiduciary duties directly to the Funds. The Defendants were duty bound to act in a responsible and lawful manner, in utmost good faith, and in

accordance with the Funds' formative documents and investment strategies, so as not to cause injury to the Funds.

70. By engaging in the conduct alleged herein, including, but not limited to, allowing Madoff and other money managers to control the Funds' assets and concealing and failing to monitor the actions of these managers despite the size of these investments, the Defendants breached their fiduciary and related obligations to the Funds. The Defendants also preferred their own interests over those of their *cestuis*, the Funds, by abdicating their responsibilities while collecting substantial fees.

71. The Funds have been damaged by the wrongful conduct of the Defendants in that the Funds lost a substantial portion of their assets, were required to pay excessive management and advisory fees to the Defendants, have been required to pay substantial legal fees by reason of that wrongful conduct and may suffer further money damages as a proximate result of that wrongful conduct.

72. The conduct of the Defendants departed in the extreme from the norms expected of persons in their position. The Defendants cavalierly disregarded their duties to, and the interests of, the Funds, and improperly preferred their own interests in order to receive greater than appropriate fees.

73. By reason of the foregoing, the Funds are entitled to a judgment against the Defendants awarding the Funds compensatory and punitive damages in an amount to be determined at trial, together with interest at the statutory rate.

**COUNT II**  
**Gross Negligence**  
**(Against Merkin and GCC)**

74. Plaintiff repeats and re-alleges each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

75. As set forth above, the Defendants agreed to, and did in fact, provide investment advisory services to the Funds.

76. As investment advisors for the Funds, the Defendants had a duty to use such skill, prudence and diligence as investment advisors of ordinary skill and capacity commonly possess and exercise in the performance of their services for or on behalf of entities such as the Funds.

77. The Defendants failed to use the requisite skill, prudence and diligence in the services they provided to the Funds. In any circumstance, their conduct would constitute gross negligence, and that is particularly true in this case.

78. Specifically, Defendants secretly concentrated as much as 90% of the Funds' assets in Madoff and Cerberus. Having done so, Defendants were obligated to exercise even greater than ordinary diligence in supervising the activities of these managers, as such conduct exposed the Funds to greater than ordinary risk. But Defendants did not do so. By way of example, Defendants performed virtually no due diligence on Madoff and exercised no supervision or control over his activities involving the Funds' assets.

79. Given the fact that Defendants knew their investments with Madoff were secret (such that none of the investors in the Funds could take any steps to monitor Madoff or protect against misconduct by him) and excessive in amount -- as much as 30% of the Funds' capital

rather than the stipulated 10% maximum -- standing alone, Defendants' *laissez-faire* attitude toward Madoff was of such a high and extreme departure from professional standards that it amounted to gross negligence on their part; and as set forth above, that *laissez-faire* attitude is but one example of Defendants' wanton disregard of the duties they owed to the Funds.

80. But for the Defendants' failure to perform their duties as investment advisors, the Funds would not have suffered the damage that occurred and is continuing. In particular, and without limitation, had the Defendants fulfilled their obligations, the Funds would not have been exposed to the Madoff fraud and would not have remitted excessive fees and commissions to the Defendants.

81. As a direct and proximate result of the wrongdoing by the Defendants described above, the Funds suffered damages in an amount to be determined at trial.

82. Moreover, as the conduct of the Defendants in flagrantly disregarding their duties to, and the interests of, the Funds was willful, purposeful, knowing, malicious, and without regard for the rights and interests of the Funds, and departed in the extreme from the norms expected of fiduciaries, the Defendants should, in addition, be liable for punitive damages in an amount to be determined at trial.

**COUNT III**  
**Fraud**  
**(Against Merkin and GCC)**

83. Plaintiff repeats and re-alleges each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

84. As set forth more specifically above, Defendants had fiduciary duties of candor and disclosure to the Funds.

85. In violation of those duties, Defendants fraudulently concealed the truth about Madoff's involvement from the Funds.

86. In addition, Defendants made affirmative misrepresentations about Madoff's role and Merkin's active involvement with the Funds' management, including, without limitation, those set forth in ¶¶ 3, 5-7, 25-38, 41, 44, 46, 49, and 67 above.

87. Defendants engaged in these material fraudulent omissions and misrepresentations knowingly and deliberately, with the specific intent that they would be relied upon by the Funds, which did rely on them to their detriment, including their payment of exorbitant fees to Defendants. Further, the Funds are now being required to bear significant legal costs the in the numerous proceedings caused by the Defendants misconduct.

88. As a direct and proximate result of the wrongdoing of Defendants described above, the Funds suffered damages in an amount to be determined at trial.

89. Moreover, the conduct of the Defendants, was willful, purposeful, knowing, malicious, and without regard for the rights and interests of the Funds and departed in the extreme from the norms expected of fiduciaries. Accordingly, the Defendants should, in addition, be liable for punitive damages in an amount to be determined at trial.

**COUNT IV**  
**Breach of Contract**  
**(Against GCC on behalf of Ariel Fund)**

90. Plaintiff repeats and re-alleges each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

91. GCC entered into investment advisory agreements with Ariel Fund throughout the life of the fund, including, but not limited to, the Ariel Fund Investment Advisory Agreement dated December 29, 2008.

92. Pursuant to these investment advisory agreements, GCC was obligated to perform its duties and obligations as the investment advisor for Ariel Fund in a competent manner.

93. GCC breached its duties and obligations under the investment advisory agreements in a number of essential ways. Specifically, GCC (through Merkin): (i) failed to ensure that Ariel Fund was invested in accordance with its investment guidelines; and (ii) failed to in any way to monitor, investigate or critically assess Madoff's purported investment strategy and practice.

94. While GCC breached its obligations to Ariel Fund, Ariel Fund fulfilled its contractual obligations by, *inter alia*, paying the requisite management and advisory fees to the Defendants.

95. As a direct and proximate result of GCC's breaches, Ariel Fund has suffered damages in an amount to be proven at trial.

**COUNT V**  
**Unjust Enrichment**  
**(Against Merkin and GCC)**

96. Plaintiff repeats and re-alleges each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

97. The Defendants were compensated and otherwise financially benefitted in connection with their unlawful acts as alleged herein. These unlawful acts caused the Funds to suffer injury and monetary loss as set forth above.

98. As a result of the foregoing misconduct, it was unjust and inequitable for the Defendants to have enriched themselves in this manner and thus the Defendants should be forced to disgorge to the Funds an amount to be determined at trial.

**COUNT VI**  
**Constructive Trust**  
**(Against Merkin and GCC)**

99. Plaintiff repeats and re-alleges each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

100. The Defendants owed fiduciary obligations and a duty of care to the Funds and have been unjustly enriched as a result of receiving substantial management and performance fees.

101. Under agreements and otherwise, the Defendants represented to the Funds that they would cause the Funds to be invested in accordance with their stated investment objectives, would supervise the efforts of outside money managers and would receive management and performance fees for actively attending to the Funds' investment activities.

102. As set forth above, the Defendants were compensated and otherwise financially benefitted in connection with their unlawful acts as alleged herein

103. By reason of the foregoing, the Funds are entitled to a constructive trust imposed on all monies and other property within the custody, possession or control of each Defendant including on (i) all management fees received by the Defendants; (ii) all performance fees received by the Defendants; and (iii) all assets or compensation received by the Defendants in connection with the business of the Funds.

**COUNT VII**  
**Rescission**  
**(Rescission of the Ariel Fund Investment Advisory Agreement Based on Mutual Mistake)**

104. Plaintiff repeats and re-alleges each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

105. Ariel Fund and GCC entered into the Ariel Fund Investment Advisory Agreement under the material mistaken assumptions that, among other things, Ariel Fund would be invested in accordance with its stated goals and that Merkin would actively manage the assets of Ariel Fund.

106. From the outset of Ariel Fund's relationship with GCC, Ariel Fund mistakenly paid management and performance fees to GCC based on Merkin's improper management of the Fund's assets.

107. Based on the foregoing, the Ariel Fund Investment Advisory Agreement should be rescinded and Ariel Fund is entitled to restitution with interest in an amount to be proven at trial.

**COUNT VIII**  
**Declaratory Judgment**  
**(Judgment Declaring that the Funds Do Not**  
**Owe Any Amounts to the Defendants)**

108. Plaintiff repeats and re-alleges each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

109. Pursuant to their agreements with the Funds, the Defendants received annual management fees equal to 1% of the capital invested in each of Ariel Fund and Gabriel Fund, in addition to an annual incentive fee totaling 20% of any appreciation in the assets of the Funds.

110. As detailed above, the Defendants have unjustly and inequitably received financial benefits as a result of their unlawful conduct.

111. By reason of the foregoing, the Funds are entitled to a judgment declaring that (i) the Funds do not owe any additional fees or commissions to the Defendants arising out of the Ariel Fund Investment Advisory Agreement, the Gabriel Fund Partnership Agreement, or otherwise; and (ii) any unpaid commissions or fees, to the extent any exist, are assets of the Funds.

**COUNT IX**  
**Declaratory Judgment**  
**(Judgment Declaring that the Funds Do Not**  
**Owe any Further Contractual Obligations to the Defendants )**

112. Plaintiff repeats and re-alleges each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

113. Pursuant to their agreements with the Funds, the Defendants may have rights of indemnification and advancement of legal expenses against the Funds.

114. As detailed above, the Defendants' conduct towards the Funds was fraudulent and/or with reckless disregard of the duties the Defendants owed to the Funds, such that the Defendants are not entitled to receive any indemnification or any other benefit from the Funds.

115. By reason of the foregoing, the Funds are entitled to a judgment declaring that (i) the Funds do not have any indemnification obligation to the Defendants arising out of the Ariel Fund Investment Advisory Agreement, the Gabriel Fund Partnership Agreement, or otherwise; and (ii) the Defendants are not entitled to demand advancement or payment of any legal expenses or fees or receive any other benefit – monetary or otherwise – from the Funds.

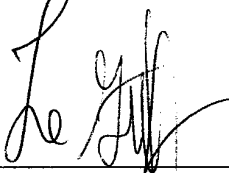
**PRAYER FOR RELIEF**

WHEREFORE, the Plaintiff respectfully prays that the Court grant the following relief:

- A. That the Funds be awarded damages in an amount to be proven at trial;
- B. That a constructive trust be imposed over all assets, property, and/or cash currently in the custody and control of each Defendant;
- C. That the Ariel Fund Investment Advisory Agreement be rescinded;
- D. That an accounting of all of the management and performance fees received by each Defendant from the Funds be granted;
- E. That a judgment be entered declaring that (i) the Funds do not owe any fees or commissions to the Defendants; (ii) any unpaid commissions or fees, to the extent any exist, are assets of the Funds; and (iii) the Funds do not have any other contractual obligations towards the Defendants;
- F. That the Funds be awarded costs, disbursements, and attorneys' fees to the fullest extent permitted by law;
- G. That the Funds be awarded punitive damages, to the fullest extent permitted by law; and
- H. That the Court order such further or additional relief as it deems just, proper and equitable.

Dated: September 16, 2010  
New York, New York

**Reed Smith LLP**

By:  \_\_\_\_\_

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LLC, and Gabriel Assets, LLC*

# **EXHIBIT E**

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*Attorneys for Irving H. Picard, Esq., Trustee for the  
Substantively Consolidated SIPA Liquidation of  
Bernard L. Madoff Investment Securities LLC  
and Bernard L. Madoff*

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

In re:

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Debtor.

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

Plaintiff,

v.

J. EZRA MERKIN, GABRIEL CAPITAL, L.P.,  
ARIEL FUND LTD., ASCOT PARTNERS, L.P.,  
GABRIEL CAPITAL CORPORATION,

Defendants.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

Adv. Pro. No. 09-1182 (BRL)

**SECOND AMENDED COMPLAINT**

Irving H. Picard, Esq. (the "Trustee"), as trustee for the 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”), by and through his undersigned counsel, for his Amended Complaint, states as follows:

**NATURE OF PROCEEDING**

1. This adversary proceeding arises from the massive Ponzi scheme perpetrated by Bernard L. Madoff (“Madoff”). In early December 2008, BLMIS generated client account statements for its nearly 7,000 client accounts at BLMIS. When added together, these statements purportedly show that clients of BLMIS had approximately \$64.8 billion invested with BLMIS. In reality, BLMIS had assets on hand worth a small fraction of that amount. On March 12, 2009, Madoff admitted to the fraudulent scheme and pled guilty to 11 felony counts. Defendants received avoidable transfers from BLMIS, and the purpose of this proceeding is to recover the avoidable transfers received by one or more of the Defendants; the value of those transfers from any general partner with legal liability for his partnership's obligations; and such portions of those transfers as may have been transferred to subsequent transferees.

2. Defendant J. Ezra Merkin (“Merkin”) is a sophisticated investment manager who was a close business and social associate of Madoff. Merkin, individually or through his company Gabriel Capital Corporation, managed several investment funds which, from at least 1995 through 2008, collectively withdrew more than \$500 million of non-existent principal from BLMIS prior to the collapse of the Ponzi scheme. In connection with these investments, Merkin, individually or through Gabriel Capital Corporation, “earned” tens of millions of dollars in management and performance fees, even though he knew or should have known that BLMIS was engaged in fraud.

3. From at least 1995 through 2008, the Defendant funds received unrealistically high and consistent annual returns of between 11% and 16% in contrast to the vastly larger fluctuations in the S & P 100 Index on which Madoff's trading activity was purportedly based during that time period. Between 1998 and 2008, more than 400 purported trades reflected on the Defendants' monthly customer account statements were allegedly exercised at prices outside the daily range for such securities traded in the market on the days in question, a fact that could easily have been confirmed by any investment professional managing the accounts. Indeed, Victor Teicher, who was retained by Merkin to manage certain of the Defendant Funds for several years, specifically advised Merkin that BLMIS' purported results were inconsistent with what could possibly take place in reality in that the returns were too consistent and the volatility was too low. On information and belief, Merkin was also advised by one of the accountants at Gabriel Capital Corporation that, based on his review of Madoff trading tickets, BLMIS looked like a fraud to him. Merkin knew or should have known that BLMIS was engaged in fraud based on these facts and the numerous other indicia of fraud described herein.

4. This adversary proceeding is brought pursuant to 15 U.S.C. §§78fff(b) and 78fff-2(c)(3), sections 105(a), 542, 544, 547, 548(a), 550(a) and 551 of 11 U.S.C. §§ 101 *et seq.* (the "Bankruptcy Code"), the New York Fraudulent Conveyance Act (N.Y. Debt & Cred. §270 *et seq.* (McKinney 2001)), and other applicable law, for turnover, accounting, preferences, fraudulent conveyances, damages and objection to claim in connection with certain transfers of property by BLMIS to or for the benefit of Defendants. The Trustee seeks to set aside such transfers and preserve the property for the benefit of BLMIS' defrauded customers.

**JURISDICTION AND VENUE**

5. This is an adversary proceeding brought in this Court, the Court in which the main underlying SIPA proceeding, No. 08-01789 (BRL) (the “SIPA Proceeding”) is pending. The SIPA Proceeding was originally brought in the United States District Court for the Southern District of New York as *Securities Exchange Commission v. Bernard L. Madoff Investment Securities LLC et al.*, No. 08 CV 10791 (the “District Court Proceeding”). This Court has jurisdiction over this adversary proceeding under 28 U.S.C. § 1334(b) and 15 U.S.C. § 78eee(b)(2)(A), (b)(4).

6. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (C), (E), (F), (H) and (O).

7. Venue in this district is proper under 28 U.S.C. § 1409.

**BACKGROUND, THE TRUSTEE AND STANDING**

8. On December 11, 2008 (the “Filing Date”), Mr. Madoff was arrested by federal agents for violation of the criminal securities laws, including, *inter alia*, securities fraud, investment adviser fraud, and mail and wire fraud. Contemporaneously, the Securities and Exchange Commission (“SEC”) filed a complaint in the District Court which commenced the District Court Proceeding against Madoff and BLMIS. The District Court Proceeding remains pending in the District Court. The SEC complaint alleged that Madoff and BLMIS engaged in fraud through the investment advisor activities of BLMIS.

9. On December 12, 2008, The Honorable Louis L. Stanton of the District Court entered an order, which appointed Lee S. Richards, Esq., as receiver for the assets of BLMIS.

10. On December 15, 2008, pursuant to 15 U.S.C. § 78eee(a)(4)(A), the SEC consented to a combination of its own action with an application of the Securities Investor Protection Corporation (“SIPC”). Thereafter, pursuant to 15 U.S.C. § 78eee(a)(4)(B), SIPC filed an application in the District Court alleging, *inter alia*, that BLMIS was not able to meet its obligations to securities customers as they came due and, accordingly, its customers needed the protections afforded by SIPA.

11. Also on December 15, 2008, Judge Stanton granted the SIPC application and entered an order pursuant to SIPA (the “Protective Decree”), which, in pertinent part:

- (a) appointed the Trustee for the liquidation of the business of BLMIS pursuant to 15 U.S.C. § 78eee(b)(3);
- (b) appointed Baker & Hostetler LLP as counsel to the Trustee pursuant to 15 U.S.C. § 78eee(b)(3); and
- (c) removed the case to this Bankruptcy Court pursuant to 15 U.S.C. § 78eee(b)(4).

12. By orders dated December 23, 2008 and February 4, 2009, respectively, the Bankruptcy Court approved the Trustee’s bond and found that the Trustee was a disinterested person. Accordingly, the Trustee is duly qualified to serve and act on behalf of the estate of BLMIS.

13. At a plea hearing (the “Plea Hearing”) on March 12, 2009, in the case captioned *United States v. Madoff*, Case No. 09-CR-213(DC), Madoff pled guilty to an 11-count criminal information filed against him by the United States Attorneys’ Office for the Southern District of New York. At the Plea Hearing, Madoff admitted that he “operated a Ponzi scheme through the investment advisory side of [BLMIS].” (Plea Hr’g Tr. at 23: 14-17.) Additionally, Madoff

asserted “[a]s I engaged in my fraud, I knew what I was doing [was] wrong, indeed criminal.”  
(Id. at 23: 20-21.)

14. As the Trustee appointed under SIPA, the Trustee has the job of recovering and paying out customer property to BLMIS’ customers, assessing claims, and liquidating any other assets of the firm for the benefit of the estate and its creditors. The Trustee is in the process of marshalling BLMIS’ assets, and the liquidation of BLMIS’ assets is well underway. However, such assets will not be sufficient to reimburse the customers of BLMIS for the billions of dollars that they invested with BLMIS over the years. Consequently, the Trustee must use his authority under SIPA and the Bankruptcy Code to pursue recovery from customers who received preferences, non-existent principal and/or payouts of fictitious profits to the detriment of other defrauded customers whose money was consumed by the Ponzi scheme. Absent this or other recovery actions, the Trustee will be unable to satisfy the claims described in subparagraphs (A) through (D) of 15 U.S.C. § 78fff-2(c)(1).

15. Pursuant to 15 U.S.C. § 78fff-1(a), the Trustee has the general powers of a bankruptcy trustee in a case under the Bankruptcy Code in addition to the powers granted by SIPA pursuant to 15 U.S.C. § 78fff(b). Chapters 1, 3, 5 and Subchapters I and II of Chapter 7 of the Bankruptcy Code are applicable to this case.

16. Pursuant to 15 U.S.C. § 78fff(7)(B), the Filing Date is deemed to be the date of the filing of the petition within the meanings of sections 547 and 548 of the Bankruptcy Code and the date of the commencement of the case within the meaning of section 544 of the Bankruptcy Code.

17. The Trustee has standing to bring these claims pursuant to 15 U.S.C. § 78fff-1 and the Bankruptcy Code, including (11 U.S.C. § 101 *et seq.*), including sections 323(b) and 704(a)(1) because, among other reasons:

(a) BLMIS incurred losses as a result of the claims set forth herein;

(b) The Trustee is a bailee of customer funds entrusted to BLMIS for investment purposes; and

(c) The Trustee is the assignee of claims paid, and to be paid, to customers of BLMIS who have filed claims in the liquidation proceeding (such claim-filing customers, collectively, “Accountholders”). As of this date, the Trustee has received multiple express unconditional assignments of the applicable Accountholders’ causes of action, which actions could have been asserted against Defendants. As assignee, the Trustee stands in the shoes of persons who have suffered injury, in fact, and a distinct and palpable loss for which the Trustee is entitled to reimbursement in the form of monetary damages.

#### **THE FRAUDULENT PONZI SCHEME**

18. BLMIS is a New York limited liability company that is wholly owned by Madoff. Founded in 1960, BLMIS operated from its principal place of business at 885 Third Avenue, New York, New York. Madoff, as founder, chairman, and chief executive officer, ran BLMIS together with several family members and a number of additional employees. BLMIS had three business units: investment advisory (the “IA Business”), market making and proprietary trading.

19. Outwardly, Madoff ascribed the IA Business’ consistent investment success to his investment strategy called the “split-strike conversion” strategy. Madoff promised clients that

their funds would be invested in a basket of common stocks within the S&P 100 Index, which is a collection of the 100 largest publicly traded companies. The basket of stocks would be intended to mimic the movement of the S&P 100 Index. Madoff asserted that he would carefully time purchases and sales to maximize value, but this meant that the clients' funds would intermittently be out of the market. During these times, Madoff asserted that the funds would be invested in United States issued securities. The second part of the split-strike conversion strategy was the hedge of such purchases with option contracts. Madoff purported to purchase and sell option contracts corresponding to the stocks in the basket, thereby controlling the downside risk of price changes in the basket of stocks.

20. Although clients of the IA Business received monthly or quarterly statements purportedly showing the securities that were held in, or had been traded through, their accounts, and the growth of and profit from those accounts over time, these statements were a complete fabrication. The security purchases and sales depicted in the account statements never occurred and the profits reported were entirely fictitious. At the Plea Hearing, Madoff admitted that he never in fact purchased any of the securities he claimed to have purchased for customer accounts. Indeed, based on the Trustee's investigation to date, there is no record of BLMIS having cleared a single purchase or sale of securities in connection with the split/strike conversion strategy at the Depository Trust & Clearing Corporation, the clearing house for such transactions, or any other trading platform on which BLMIS could have reasonably traded securities.

21. Prior to his arrest, Madoff assured clients and regulators that he conducted trades on the over-the-counter market, after hours. To bolster that lie, Madoff periodically wired tens of millions of dollars to BLMIS' affiliate, Madoff Securities International Ltd. ("MSIL"), a

London based entity wholly owned by Madoff. There are no records that MSIL ever used the wired funds to purchase securities for the accounts of the IA Business clients.

22. Additionally, based on the Trustee's investigation to date, there is no evidence that the IA Business ever purchased or sold any of the options that Madoff claimed on customer statements to have purchased. All traded options related to S&P 100 companies, including options on the index itself, clear through the Options Clearing Corporation ("OCC"). Based on the Trustee's investigation to date, the OCC has no records of the IA Business having transacted in any exchange-listed options.

23. For all periods relevant hereto, the IA Business was operated as a Ponzi scheme and Madoff and BLMIS concealed the ongoing fraud in an effort to hinder and delay other current and prospective customers of BLMIS from discovering the fraud. The money received from investors was not set aside to buy securities as purported, but instead was primarily used to make the distributions to, or payments on behalf of, other investors. The money sent to BLMIS for investment, in short, was simply used to keep the operation going and to enrich Madoff, his associates and others, including certain of the Defendants, until such time as the requests for redemptions in December 2008 overwhelmed the flow of new investments and caused the inevitable collapse of the Ponzi scheme.

24. During the scheme, certain investors requested and received distributions of the "profits" listed for their accounts which were nothing more than fictitious profits. Other investors, from time to time, redeemed or closed their accounts, or removed portions of them, and were paid consistently with the statements they had been receiving. Some of those investors later re-invested part or all of those withdrawn payments with BLMIS.

25. When payments were made to or on behalf of these investors, including the Defendants, the falsified monthly statements of accounts reported that the accounts of such investors included substantial gains. In reality, BLMIS had not invested the investors' principal as reflected in customer statements. In an attempt to conceal the ongoing fraud and thereby hinder, delay, and defraud other current and prospective investors, BLMIS paid to or on behalf of certain investors the inflated amount reflected in the falsified financial statements, including non-existent principal and fictitious profits, not such investors' true depleted account balances.

26. BLMIS used the funds deposited from investors or investments to continue operations and pay redemption proceeds to or on behalf of other investors and to make other transfers. Due to the siphoning and diversion of new investments to pay requests for payments or redemptions from other account holders, BLMIS did not have the funds to pay investors on account of their new investments. BLMIS was able to stay afloat only by using the principal invested by some clients to pay other investors or their designees.

27. In an effort to hinder, delay and defraud authorities from detecting the fraud, BLMIS did not register as an Investment Advisor until September 2006.

28. In or about January 2008, BLMIS filed with the SEC a Uniform Application for Investment Adviser Registration. The application represented, *inter alia*, that BLMIS had 23 customer accounts and assets under management of approximately \$17.1 billion. In fact, in January 2008, BLMIS had over 4,900 active customer accounts with a purported value of approximately \$68 billion under management.

29. Not only did Madoff seek to evade regulators, Madoff also had false audit reports "prepared" by Friehling & Horowitz, a three person accounting firm in Rockland County, New

York. Of the three employees at the firm, one employee was an assistant and one was a semi-retired accountant living in Florida. On or about November 3, 2009, David Friebling, the sole proprietor of Friebling & Horowitz, pleaded guilty to filing false audit reports on behalf of BLMIS and filing false tax returns on behalf of Madoff and others.

30. At all times relevant hereto, the liabilities of BLMIS were billions of dollars greater than the assets of BLMIS. At all times relevant hereto, BLMIS was insolvent in that (i) its assets were worth less than the value of its liabilities; (ii) it could not meet its obligations as they came due and (iii) at the time of the transfers, BLMIS was left with insufficient capital.

31. This and similar complaints are being brought to recapture monies paid to or for the benefit of certain investors so that this customer property can be equitably distributed among all of the victims of BLMIS in accordance with the provisions of SIPA.

#### **THE DEFENDANTS AND THE TRANSFERS**

32. Defendant J. Ezra Merkin (“Merkin”) is a citizen of the State of New York, residing at 740 Park Avenue, New York, New York 10021. On information and belief, Merkin has been closely associated with Madoff on both a business and social level since at least the 1990’s, and among other things sat on the Board of Trustees of Yeshiva University with Madoff. Defendant Merkin also had a close working relationship with Victor Teicher, who was convicted in 1990 of securities fraud for trading on the basis of material non-public information that Teicher knew had been misappropriated, fraud in connection with a tender offer, and conspiracy, as a result of which Teicher was barred from associating with any broker, dealer, investment company, investment advisor, or municipal securities dealer.

33. Defendant Gabriel Capital Corporation (“GCC”) is a corporation, organized under the laws of Delaware, with a principal place of business at 450 Park Avenue, #3201, New York, New York 10022. Merkin is the sole shareholder and sole director of GCC.

34. Defendant GCC has been dominated by and used merely as the instrument of Defendant Merkin to advance his personal interests rather than corporate ends. Merkin exercised complete domination of GCC in dealing with BLMIS, which he knew or should have known was predicated on fraud. As a result, GCC functioned as the alter ego of Merkin and no corporate veil can be maintained between them.

35. Defendant Gabriel Capital, L.P. (“Gabriel”) is a limited partnership, organized under the laws of Delaware, with a principal place of business at 450 Park Avenue, #3201, New York, New York 10022. Merkin was at all relevant times the sole general partner of Gabriel.

36. Defendant Ariel Fund Limited (“Ariel”) is a mutual fund, organized under the Mutual Funds Law of the Cayman Islands, with a principal place of business at 450 Park Avenue, #3201, New York, New York 10022. GCC was at all relevant times the Investment Advisor to Ariel.

37. Defendant Ascot Partners, L.P. (“Ascot”) is a limited partnership, organized under the laws of Delaware, with a principal place of business at 450 Park Avenue, #3201, New York, New York 10022. Ascot includes the former Ascot Fund, Ltd., which was merged into Ascot in early 2003. Ascot is insolvent, and its assets are insufficient to satisfy any judgment on the claims asserted herein. Merkin was at all relevant times the sole general partner of Ascot. Gabriel, Ariel and Ascot are collectively referred to herein as the “Defendant Funds.”

38. At all times relevant hereto, one or more of the Defendants was a client of the IA Business. According to BLMIS' records, Defendants Gabriel, Ariel and Ascot maintained the accounts with BLMIS set forth on Exhibit A (the "Accounts"). The Accounts were opened on or about the dates set forth on Exhibit A. Each of the Defendant funds executed a Customer Agreement, an Option Agreement, and a Trading Authorization Limited to Purchases and Sales of Securities and Options, (the "Account Agreements") and delivered such papers to BLMIS at BLMIS' headquarters at 885 Third Avenue, New York, New York.

39. By their terms, the Account Agreements were deemed to be entered into in the State of New York and were to be performed in New York, New York through securities trading activities that would take place in New York, New York. The Accounts were held in New York, New York, and the Defendants consistently wired funds to the BLMIS Bank Account in New York, New York for application to the Account and the conducting of trading activities.

40. Beginning sometime before 1995, Defendant Funds invested heavily with BLMIS. Between December 1, 1995 and the Filing Date, the Defendants invested over one billion dollars with BLMIS through 56 separate wire transfers directly into BLMIS' account at JPMorgan Chase & Co., which from at least 2001 through 2008 was Account # 000000140081703 (the "BLMIS Bank Account"). The BLMIS Bank Account was maintained at a JPMorgan Chase & Co. branch in New York, New York. Defendants have intentionally taken advantage of the benefits of conducting transactions in the State of New York and have submitted themselves to the jurisdiction of this Court for purposes of this proceeding.

41. Prior to the filing date, BLMIS made payments or other transfers (collectively, the "Transfers") to one or more of the Defendants. The Transfers were made to or for the benefit of

one of more of the Defendants and include, but are not limited to, the Transfers listed on Exhibit B.

42. Defendants Merkin and GCC managed the assets of Defendants Gabriel, Ariel and Ascot, which management included directing where those assets were to be invested. Merkin and GCC had ultimate responsibility for the management, operations and investment decisions made on behalf of the Defendant Funds. Defendants were paid or received, directly or indirectly, substantial fees from BLMIS in connection with their management duties.

43. As general partner of Ascot, Merkin had ultimate responsibility for the operation and management of the partnership, including the authority to make investment decisions, admit new partners, withdraw his own capital or terminate the partnership, and is personally liable as a matter of state law for the debts and obligations of the partnership, including the preferential and fraudulent transfers received by Ascot as set forth herein.

44. Upon information and belief, Defendants knew or should have known that Madoff's IA Business was predicated on fraud. Hedge funds and funds of funds like the Defendants were sophisticated investors that accepted fees from their customers based on purported assets under management and/or stock performance in consideration for the diligence they were expected to exercise in selecting and monitoring investment managers like Madoff. The Defendants failed to exercise reasonable due diligence of BLMIS and its auditors in connection with the Ponzi scheme. Among other things, the Defendants were on notice of the following indicia of irregularity and fraud but failed to make sufficient inquiry:

a. Financial industry press reports, including a May 27, 2001 article in Barron's entitled "Don't Ask, Don't Tell: Bernie Madoff is so secretive, he even asks investors to keep

mum,” and a May, 2001 article in MAR/Hedge, a semi-monthly newsletter that is widely read by hedge fund industry professionals, entitled “Madoff Tops Charts; Skeptics Ask How,” raised serious questions about the legitimacy of BLMIS and Madoff and their ability to achieve the IA Business returns they purportedly had achieved using the split-strike conversion strategy Madoff claimed to employ. Defendants actually received one or both of the referenced articles.

b. Madoff avoided questions about his IA Business operations, was consistently vague in responding to any such questions, and operated with no transparency. Madoff even instructed Defendants not to inform their investors that BLMIS was their money manager.

c. BLMIS did not provide its customers with electronic real-time online access to their accounts, which was and is customary in the industry for hedge fund and fund of funds investors. BLMIS also utilized outmoded technology, including paper trading confirmations, despite Madoff’s history of being in the forefront of computer-based trading. The use of paper confirmations created after the fact was critical to Madoff’s ability to perpetuate his Ponzi scheme.

d. BLMIS functioned as both investment manager and custodian of securities. This arrangement eliminated another frequently utilized check and balance in investment management by excluding an independent custodian of securities from the process, and thereby furthering the lack of transparency of BLMIS to investors, regulators, and other outside parties.

e. BLMIS produced returns that were too good to be true, reflecting a pattern of abnormal profitability, both in terms of consistency and amount, that was simply not credible. Specifically, for Defendant Ascot there were only 4 months with negative returns during the 144 months of reported operations from January 1996 through December 2007, during which Ascot

was a customer of BLMIS. For both Defendants Ariel and Gabriel, there were only 4 months with a negative return during the 100 months of reported operations from August 2000 through November 2008, during which Ariel and Gabriel were customers of BLMIS. Returns this good could not be reproduced by other skilled hedge fund managers, and those managers who attempted to employ the split-strike conversion strategy purportedly used by BLMIS consistently failed even to approximate its results.

f. The Defendants received far higher purported annual rates of return on their investments with BLMIS, ranging on average from about 11% to 16%, as compared to the interest rates BLMIS could have paid to commercial lenders during the relevant time period. Upon information and belief, the Defendants never questioned why Madoff accepted their investment capital in lieu of other available alternatives that would have been more lucrative for BLMIS.

g. At times the Defendants' monthly account statements reflected trades purchased or sold on behalf of the Defendants' accounts in certain securities that were allegedly executed at prices outside the daily range of prices for such securities traded in the market on the days in question. The Defendants received purported trade confirmations from BLMIS matching the securities transactions reported on the monthly account statements which, if verified with the prices in the market on the trade dates in question, would have revealed that the trades could not have been executed at the prices reported. For example, Defendant Ascot's October 2003 monthly account statement reported a purchase of 641,718 shares of Intel Corporation (INTC) with the settlement date of October 7, 2003, which was purportedly executed on the trade date of October 2, 2003 at a price of \$27.63. The daily price for Intel Corporation stock on October 2, 2003 ranged from a low of \$28.41 to a high of \$28.95, which made the reported price

impossible. Similar impossibilities were reported in connection with purported sales of securities in all of the Defendants' accounts. Defendants' December 2006 account statements reported sales of 169,224 shares, 21,315 shares and 27,191 shares of Merck (MRK) respectively, each of which were purportedly executed at a price of \$44.61 on the trade date of December 22, 2006 with a settlement date of December 28, 2006. The daily price for Merck stock on December 22 ranged from a low of \$42.78 to a high of \$43.42, more than \$1 below the price reported on the statements.

h. The Trustee's investigation to date has revealed over 500 instances between January 1998 to November 2008 in which Defendants' account statements displayed trades purportedly executed at a price outside the daily price range. This pattern in each of Defendants' accounts should have caused a sophisticated hedge fund manager like Merkin to independently verify the trades with the public exchanges and demand more transparency into the operations of BLMIS.

i. BLMIS would have had to execute massive numbers of options trades to implement its purported split-strike conversion strategy. In order to implement this strategy, BLMIS purportedly purchased options on the S&P 100 index ("OEX") – which are traded on the Chicago Board Options Exchange ("CBOE") – in combination with purchases of select underlying stocks that are components of that index. At times, the option volume BLMIS reported to its customers was simply impossible if those options had been exchange-traded. For example, on January 23, 2008, BLMIS purportedly bought a total of 11,967 and 2,028 OEX put options (with February expiration and a strike price of 600) for Ascot and Ariel, respectively, when the total volume traded on the CBOE for all such contracts that day was 8,645. Similarly, BLMIS purportedly bought a total of 11,967 and 2,028 OEX call options (with February

expiration and a strike price of 610) for Ascot and Ariel, respectively, when the total volume traded on the CBOE for all such contracts that day was 631. In each of these instances, Defendants knew or should have known that the option trading volumes reported by BLMIS were impossible if exchange-traded.

j. BLMIS had purportedly told its investors that it purchased these options in the over-the-counter (“OTC”) market. Trading options in the OTC market would likely have been more expensive than trading over the CBOE, yet those costs did not appear to be passed on to BLMIS’ investors. The absence of such costs, together with BLMIS’ representation that it was trading in the OTC market, should have prompted a sophisticated hedge fund manager like Merkin to request verification of the trades and demand more transparency into the operations of BLMIS.

k. BLMIS’ statements to investors reflected a consistent ability to trade stocks near their monthly highs and lows to generate consistent and unusual profits (or, if requested by Defendants to generate losses, to do the opposite). No experienced investment professional could have reasonably believed that this could have been accomplished legitimately.

l. BLMIS, which reputedly ran the world’s largest hedge fund, was purportedly audited by Friebling & Horowitz, an accounting firm that had three employees, one of whom was semi-retired, with offices located in a strip mall. No experienced investment professional could have reasonably believed it possible for any such firm to have competently audited an entity the size of BLMIS.

m. The compensation system utilized by BLMIS was atypical in that BLMIS, the entity purportedly employing the hugely-successful and secret proprietary trading system, was

compensated only for the trades that it executed, while Defendants, whose only role was to funnel money to BLMIS, received administrative fees and a share of the profits that would normally go to the entity in the position of BLMIS. This compensation arrangement, together with the lack of transparency and other factors listed herein, should have caused an experienced investment professional like Merkin to question Madoff's operation.

n. Despite its immense size, BLMIS was substantially a family-run operation, employing many of Madoff's relatives, and virtually no outside professionals. Indeed, the comptroller for BLMIS was based in Bermuda and was not an in-house comptroller with full access to information about BLMIS operations.

o. At no time did the Defendants conduct a performance audit of BLMIS or match any trade confirmations provided by BLMIS with actual trades executed through any domestic or foreign public exchange despite the fact the Defendant Funds had hundreds of millions of dollars in assets and easily could have afforded to do this.

p. Based on all of the foregoing factors, many banks, industry advisors and insiders who made an effort to conduct reasonable due diligence flatly refused to deal with BLMIS and Madoff because they had serious concerns that their IA Business operations were not legitimate.

q. BLMIS purported to convert all of its holdings to cash immediately before each quarterly report, a strategy that had no practical benefit but which had the effect of shielding BLMIS' purported trading activities from scrutiny.

r. Victor Teicher, who had a close working relationship with Defendants for a number of years, and who actually managed some of the Defendant Funds for several years,

specifically warned Defendants that Madoff's purported results were impossible to achieve, and that he was certain Madoff was altering trading confirmations. Other highly-regarded Wall Street professionals also warned Defendants that Madoff did not appear to be legitimate.

s. Defendants misled investors as to Madoff's role in the operation of the funds, and in fact sought to conceal that role.

t. Defendants enjoyed unusually intimate access to Madoff. Merkin and Madoff were friends. Merkin sat on the Board of Trustees of Yeshiva University with Madoff, and re-directed university investments entrusted to him to Madoff. Their friendship, shared fiduciary obligations and heightened access allowed Defendants an almost unique opportunity to gain access to extensive information about the operations of BLMIS.

45. The Transfers were and continue to be customer property within the meaning of 15 U.S.C. § 7811(4), and are subject to turnover pursuant to section 542 of the Bankruptcy Code.

46. The Transfers were, in part, false and fraudulent payments of nonexistent profits supposedly earned in the Accounts ("Fictitious Profits").

47. The Transfers are avoidable and recoverable under sections 544, 550(a)(1) and 551 of the Bankruptcy Code, applicable provisions of SIPA, particularly 15 U.S.C. § 78fff-2(c)(3), and applicable provisions of N.Y. CPRL 203(g) (McKinney 2001) and N.Y. Debt. & Cred. §§ 273 – 276 (McKinney 2001).

48. Of the Transfers, at least eleven transfers in the collective amount of \$494,600,000 (the "Six Year Transfers") were made during the six years prior to the Filing Date and are avoidable and recoverable under sections 544, 550(a)(1) and 551 of the Bankruptcy

Code, applicable provisions of SIPA, particularly 15 U.S.C. § 78fff-2(c)(3), and applicable provisions of N.Y. Debt. & Cred. §§ 273 – 276.

49. Of the Six Year Transfers, at least six in the collective amount of \$313,600,000 (the “Two Year Transfers”) were made during the two years prior to the Filing Date, and are additionally recoverable under sections 548(a)(1), 550(a)(1) and 551 of the Bankruptcy Code and applicable provisions of SIPA, particularly 15 U.S.C. 78fff-2(c)(3).

50. Of the Two Year Transfers, one to Ascot in the amount of \$45,000,000 (the “90 Day Transfer”) was made during the 90 days prior to the Filing Date, and is additionally recoverable under sections 547, 550(a)(1) and 551 of the Bankruptcy Code and applicable provisions of SIPA, particularly 15 U.S.C. § 78fff-2(c)(3), subject to a credit for \$10,000,000 deposited by Ascot into the BLMIS account subsequent to its receipt of the aforesaid \$45,000,000 transfer.

51. To the extent that any of the recovery counts may be inconsistent with each other, they are to be treated as being pled in the alternative.

52. The Trustee’s investigation is on-going and the Trustee reserves the right to (i) supplement the information on the Transfers and any additional transfers, and (ii) seek recovery of such additional transfers.

**COUNT ONE**  
**TURNOVER AND ACCOUNTING – 11 U.S.C. § 542**

53. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

54. The Transfers constitute property of the estate to be recovered and administered by the Trustee pursuant to section 541 of the Bankruptcy Code and 15 U.S.C. § 78fff-2(c)(3).

55. As a result of the foregoing, pursuant to section 542 of the Bankruptcy Code, the Trustee is entitled to the immediate payment and turnover from the Defendants of any and all Transfers made by BLMIS, directly or indirectly, to any Defendant.

56. As a result of the foregoing, pursuant to section 542 of the Bankruptcy Code, the Trustee is also entitled to an accounting of all such Transfers received by any Defendant from BLMIS, directly or indirectly.

**COUNT TWO**  
**PREFERENTIAL TRANSFERS – 11 U.S.C. §§ 547(b), 550 AND 551**

57. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

58. At the time of each of the 90 Day Transfers (hereafter, the “Preference Period Transfers”), Defendant Ascot was a “creditor” of BLMIS within the meaning of section 101(10) of the Bankruptcy Code and pursuant to 15 U.S.C. § 78fff-2(c)(3).

59. Each of the Preference Period Transfers constitutes a transfer of an interest of BLMIS in property within the meaning of section 101(54) of the Bankruptcy Code and pursuant to 15 U.S.C. § 78fff-2(c)(3).

60. Each of the Preference Period Transfers was to or for the benefit of Defendant Ascot.

61. Pleading in the alternative, each of the Preference Period Transfers was made on account of an antecedent debt owed by BLMIS before such transfer was made.

62. Each of the Preference Period Transfers was made while BLMIS was insolvent.

63. Each of the Preference Period Transfers was made during the preference period under section 547(b)(4) of the Bankruptcy Code.

64. Each of the Preference Period Transfers enabled Defendant Ascot to receive more than the receiving Defendant would receive if (i) this case was a case under chapter 7 of the Bankruptcy Code, (ii) the transfers had not been made, and (iii) Defendant Ascot received payment of such debt to the extent provided by the provisions of the Bankruptcy Code.

65. Each of the Preference Period Transfers constitutes a preferential transfer avoidable by the Trustee pursuant to section 547(b) of the Bankruptcy Code and recoverable from Defendant Ascot pursuant to section 550(a).

66. As a result of the foregoing, the Trustee is entitled to a judgment pursuant to sections 547(b), 550, and 551 of the Bankruptcy Code: (a) avoiding and preserving the Preference Period Transfers, (b) directing that the Preference Period Transfers be set aside and (c) recovering the Preference Period Transfers, or the value thereof, for the benefit of the estate of BLMIS.

**COUNT THREE**  
**FRAUDULENT TRANSFERS – 11 U.S.C. §§ 548(a)(1)(A), 550 AND 551**

67. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

68. The Two Year Transfers were made on or within two years before the filing date of BLMIS' case.

69. The Two Year Transfers were made by BLMIS with the actual intent to hinder, delay, and defraud some or all of BLMIS' then existing or future creditors.

70. The Two Year Transfers constitute a fraudulent transfer avoidable by the Trustee pursuant to section 548(a)(1)(A) of the Bankruptcy Code and recoverable from the Defendants pursuant to section 550(a).

71. As a result of the foregoing, pursuant to sections 548(a)(1)(A), 550(a) and 551 of the Bankruptcy Code, the Trustee is entitled to a judgment: (a) avoiding and preserving the Two Year Transfers, (b) directing that the Two Year Transfers be set aside, and (c) recovering the Two Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS.

**COUNT FOUR**  
**FRAUDULENT TRANSFER – 11 U.S.C. §§ 548(a)(1)(B) , 550 AND 551**

72. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

73. The Two Year Transfers were made on or within two years before the Filing Date.

74. BLMIS received less than a reasonably equivalent value in exchange for each of the Two Year Transfers.

75. At the time of each of the Two Year Transfers, BLMIS was insolvent, or became insolvent as a result of the Two Year Transfer in question.

76. At the time of each of the Two Year Transfers, BLMIS was engaged in a business or a transaction, or was about to engage in business or a transaction, for which any property remaining with BLMIS was an unreasonably small capital.

77. At the time of each of the Two Year Transfers, BLMIS intended to incur, or believed that it would incur, debts that would be beyond BLMIS' ability to pay as such debts matured.

78. The Two Year Transfers constitute fraudulent transfers avoidable by the Trustee pursuant to section 548(a)(1)(B) of the Bankruptcy Code and recoverable from the Defendants pursuant to section 550(a).

79. As a result of the foregoing, pursuant to sections 548(a)(1)(B), 550(a) and 551 of the Bankruptcy Code, the Trustee is entitled to a judgment: (a) avoiding and preserving the Two Year Transfers, (b) directing that the Two Year Transfers be set aside, and (c) recovering the Two Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS.

**COUNT FIVE**  
**FRAUDULENT TRANSFER – NEW YORK DEBTOR AND CREDITOR LAW**  
**§§ 276, 276-a, 278 AND/OR 279, AND 11 U.S.C. §§ 544, 550(a) AND 551**

80. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

81. At all times relevant to the Six Year Transfers, there have been one or more creditors who have held and still hold matured or unmatured unsecured claims against BLMIS that were and are allowable under section 502 of the Bankruptcy Code or that were and are not allowable only under section 502(e).

82. The Six Year Transfers were made by BLMIS with the actual intent to hinder, delay, or defraud the creditors of BLMIS. BLMIS made the Six Year Transfers to or for the benefit of the Defendants in furtherance of a fraudulent investment scheme.

83. As a result of the foregoing, pursuant to sections 276, 276-a, 278 and/or 279 of the New York Debtor and Creditor Law, sections 544(b), 550(a), and 551 of the Bankruptcy Code, and 15 U.S.C. § 78fff-2(c)(3), the Trustee is entitled to a judgment: (a) avoiding and preserving the Six Year Transfers, (b) directing that the Six Year Transfers be set aside; (c) recovering the Six Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS, and (d) recovering attorneys' fees from the Defendants.

**COUNT SIX**  
**FRAUDULENT TRANSFER – NEW YORK DEBTOR AND CREDITOR LAW**  
**§§ 273 AND 278 AND/OR 279, AND 11 U.S.C. §§ 544, 550(A), 551 AND 1107**

84. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

85. At all relevant times there was and is at least one or more creditors who held and hold matured or unmatured unsecured claims against BLMIS that were and are allowable under section 502 of the Bankruptcy Code or that were and are not allowable only under section 502(e).

86. BLMIS did not receive fair consideration for the Six Year Transfers.

87. BLMIS was insolvent at the time it made each of the Six Year Transfers or, in the alternative, BLMIS became insolvent as a result of each of the Six Year Transfers.

88. As a result of the foregoing, the Trustee is entitled to a judgment pursuant to sections 273, 278 and 279 of the New York Debtor and Creditor Law and sections 544(b), 550, 551 of the Bankruptcy Code: (a) avoiding and preserving the Six Year Transfers, (b) directing that the Six Year Transfers be set aside, and (c) recovering the Six Year Transfers, or the value thereof, for the benefit of the estate of BLMIS.

**COUNT SEVEN**  
**FRAUDULENT TRANSFERS – NEW YORK DEBTOR AND CREDITOR LAW**  
**§§274, 278 AND/OR 279, AND 11 U.S.C. §§ 544, 550(A), 551 AND 1107**

89. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

90. At all relevant times there was and is at least one or more creditors who held and hold matured or unmatured unsecured claims against BLMIS that were and are allowable under section 502 of the Bankruptcy Code or that were and are not allowable only under section 502(e).

91. BLMIS did not receive fair consideration for the Six Year Transfers.

92. At the time BLMIS made each of the Six Year Transfers, BLMIS was engaged or was about to engage in a business or transaction for which the property remaining in its hands after each of the Six Year Transfers was an unreasonably small capital.

93. As a result of the foregoing, pursuant to sections 274, 278 and/or 279 of the New York Debtor and Creditor Law and sections 544(b) and 550(a) of the Bankruptcy Code, the Trustee is entitled to a judgment: (a) avoiding and preserving the Six Year Transfers, (b) directing that the Six Year Transfers be set aside, and (c) recovering the Six Year Transfers , or the value thereof, from the Defendants for the benefit of the estate of BLMIS.

**COUNT EIGHT**  
**FRAUDULENT TRANSFERS – NEW YORK DEBTOR AND CREDITOR LAW**  
**§§ 275, 278 AND/OR 279, AND 11 U.S.C. §§ 544, 550(A) AND 551**

94. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

95. At all relevant times there was and is at least one or more creditors who held and hold matured or unmatured unsecured claims against BLMIS that were and are allowable under section 502 of the Bankruptcy Code or that were and are not allowable only under section 502(e).

96. BLMIS did not receive fair consideration for the Six Year Transfers.

97. At the time BLMIS made each of the Six Year Transfers, BLMIS had incurred, was intending to incur, or believed that it would incur debts beyond its ability to pay them as the debts matured.

98. As a result of the foregoing, pursuant to sections 275, 278 and/or 279 of the New York Debtor and Creditor Law and sections 544(b), 550(a), and 551 of the Bankruptcy Code, the Trustee is entitled to a judgment: (a) avoiding and preserving the Six Year Transfers, (b)

directing that the Six Year Transfers be set aside, and (c) recovering the Six Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS.

**COUNT NINE**  
**UNDISCOVERED FRAUDULENT TRANSFERS – NEW YORK CIVIL PROCEDURE**  
**LAW AND RULES 203(g) AND NEW YORK DEBTOR AND CREDITOR LAW**  
**§§ 276, 276-a, 278 AND/OR 279, AND 11 U.S.C. §§ 544, 550(a) AND 551**

99. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

100. At all times relevant to Transfers, the fraudulent scheme perpetrated by BLMIS was not reasonably discoverable by at least one unsecured creditor of BLMIS.

101. At all times relevant to the Transfers, there have been one or more creditors who have held and still hold matured or unmatured unsecured claims against BLMIS that were and are allowable under section 502 of the Bankruptcy Code or that were and are not allowable only under section 502(e).

102. The Transfers were made by BLMIS with the actual intent to hinder, delay, or defraud the creditors of BLMIS. BLMIS made the Transfers to or for the benefit of the Defendants in furtherance of a fraudulent investment scheme.

103. As a result of the foregoing, pursuant to NY CPLR 203(g) sections 276, 276-a, 278 and/or 279 of the New York Debtor and Creditor Law, sections 544(b), 550(a), and 551 of the Bankruptcy Code, and 15 U.S.C. § 78fff-2(c)(3), the Trustee is entitled to a judgment: (a) avoiding and preserving the Transfers, (b) directing that the Transfers be set aside; (c) recovering the Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS, and (d) recovering attorneys' fees from the Defendants.

**COUNT TEN**

**RECOVERY OF SUBSEQUENT TRANSFERS – NEW YORK DEBTOR AND CREDITOR LAW § 278 AND 11 U.S.C. §§ 544, 547, 548, 550(A), AND 551**

104. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

105. Each of the Transfers is avoidable under sections 544, 547 and/or 548 of the Bankruptcy Code.

106. On information and belief, some or all of the Transfers were subsequently transferred by Defendant Gabriel, Ariel or Ascot directly or indirectly to Defendants Merkin and/or GCC in the form of payment of commissions or fees (collectively, the “Subsequent Transfers”).

107. Each of the Transfers was made directly or indirectly to Defendant Merkin and/or GCC.

108. Defendants Merkin and GCC are immediate or mediate transferees of the Subsequent Transfers from Defendants Ascot, Ariel and Gabriel.

109. As a result of the foregoing, pursuant to section 278 of the New York Debtor and Creditor Law, sections 550(a) and 551 of the Bankruptcy Code, and 15 U.S.C. § 78fff-2(c)(3), the Trustee is entitled to a judgment against Defendants Merkin and GCC: (a) preserving the Subsequent Transfers, (b) recovering the Subsequent Transfers, or the value thereof, from Defendants Merkin and GCC for the benefit of the estate of BLMIS, and (c) recovering attorneys’ fees from defendants Merkin and GCC.

**COUNT ELEVEN**

**GENERAL PARTNER LIABILITY**

110. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Second Amended Complaint as if fully rewritten herein.

111. At all times relevant to the Transfers to Defendant Ascot, Defendant Merkin was the sole general partner of Ascot.

112. Defendant Ascot is insolvent, and its assets are insufficient to satisfy any judgment on the claims asserted herein.

113. As a result of the foregoing, pursuant to applicable state law, Defendant Merkin is jointly and severally liable for all debts and obligations of Defendant Ascot, and the Trustee is entitled to a judgment against Defendant Merkin recovering the value of the Transfers to Defendant Ascot from Defendant Merkin for the benefit of the estate of BLMIS.

**COUNT TWELVE**

**OBJECTION TO DEFENDANTS' SIPA CLAIMS**

114. The Trustee incorporates by reference the allegations contained in the previous paragraphs of this Amended Complaint as if fully rewritten herein.

115. One of more Defendants has filed, or will file, a SIPA claim.

116. Defendants' claims (the "Claims") are not supported by the books and records of BLMIS nor the claim materials submitted by Defendants, and, therefore, should be disallowed.

117. The Claims also should not be allowed as general unsecured claims. Defendants are the recipients of transfers of BLMIS' property which are recoverable under sections 547, 548 and 550 of the Bankruptcy Code, and Defendants have not returned the Transfers to the Trustee. As a result, pursuant to section 502(d) the Claims must be disallowed unless and until the Defendants return the Transfers to the Trustee.

118. As a result of the foregoing, the Trustee is entitled to an order disallowing the Claims.

**WHEREFORE**, the Trustee respectfully requests that this Court enter judgment in favor of the Trustee and against the Defendants as follows:

i. On the First Claim for Relief, pursuant to section 542, 550(a) and 551 of the Bankruptcy Code: (a) that the property that was the subject of the Transfers be immediately delivered and turned over to the Trustee, and (b) for an accounting by the Defendants of the property that was the subject of the Transfers or the value of such property;

ii. On the Second Claim for Relief, pursuant to sections 547, 550(a) and 551 of the Bankruptcy Code: (a) avoiding and preserving the Preference Period Transfer(s), (b) directing that the Preference Period Transfers be set aside, and (c) recovering the Preference Period Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS;

iii. On the Third Claim for Relief, pursuant to sections 548(a)(1)(A), 550(a) and 551 of the Bankruptcy Code: (a) avoiding and preserving the Two Year Transfers, (b) directing that the Two Year Transfers be set aside, and (c) recovering the Two Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS;

iv. On the Fourth Claim for Relief, pursuant to sections 548(a)(1)(B), 550(a) and 551 of the Bankruptcy Code: (a) avoiding and preserving the Two Year Transfers, (b) directing that

the Two Year Transfers be set aside, and (c) recovering the Two Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS;

v. On the Fifth Claim for Relief, pursuant to sections 276, 276-a, 278 and/or 279 of the New York Debtor & Creditor Law and sections 544(b), 550(a) and 551 of the Bankruptcy Code: (a) avoiding and preserving the Six Year Transfers, (b) directing that the Six Year Transfers be set aside, and (c) recovering the Six Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS, and (d) recovering attorneys' fees from the Defendants;

vi. On the Sixth Claim for Relief, pursuant to sections 273, 278 and/or 279 of the New York Debtor and Creditor Law and sections 544(b), 550 and 551 of the Bankruptcy Code: (a) avoiding and preserving the Six Year Transfers, (b) directing that the Six Year Transfers be set aside, and (c) recovering the Six Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS;

vii. On the Seventh Claim for Relief, pursuant to sections 274, 278 and/or 279 of the New York Debtor and Creditor Law and sections 544(b), 550, 551 and 1107 of the Bankruptcy Code: (a) avoiding and preserving the Six Year Fraudulent Transfers, (b) directing the Six Year Transfers be set aside, and (c) recovering the Six Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS;

viii. On the Eighth Claim for Relief, pursuant to New York Debtor and Creditor Law §§ 275, 278 and/or 279 and Bankruptcy Code §§ 544(b), 550, 551 and 1107: (a) avoiding and preserving the Six Year Transfers, (b) directing that the Six Year Transfers be set aside, and (c) recovering the Six Year Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS;

ix. On the Ninth Claim for Relief, pursuant to NY CPLR 203(g) and sections 276, 276-a, 278 and/or 279 of the New York Debtor & Creditor Law and section 544(b), 550(a) and 551 of the Bankruptcy Code: (a) avoiding and preserving the Transfers, (b) directing that the Transfers be set aside, and (c) recovering the Transfers, or the value thereof, from the Defendants for the benefit of the estate of BLMIS, and (d) recovering attorneys' fees from the Defendants.

x. On the Tenth Claim for Relief, pursuant to section 278 of the New York Debtor and Creditor Law, sections 550(a) and 551 of the Bankruptcy Code, and 15 U.S.C. § 78fff-2(c)(3); (a) preserving the Subsequent Transfers, (b) directing that the Subsequent Transfers be set aside; (c) recovering the Subsequent Transfers, or the value thereof, from Defendant Merkin and GCC for the benefit of the estate of BLMIS, and (d) recovering attorneys' fees from Defendants Merkin and GCC.

xi. On the Eleventh Claim for Relief, recovering the value of the Transfers to Defendant Ascot from Defendant Merkin for the benefit of the estate of BLMIS.

xii. On the Twelfth Claim for Relief, that the claim or claims of Defendants be disallowed;

xiii. On all Claims for Relief for which Ascot is liable, that the Court enter judgment for that same relief against Merkin as general partner of Ascot;

xiv. On all Claims for Relief, pursuant to federal common law and N.Y. CPLR 5001, 5004 awarding the Trustee prejudgment interest from the date on which the Transfers were received;

xv. On all Claims for Relief, establishment of a constructive trust over the proceeds of the transfers in favor of the Trustee for the benefit of BLMIS's estate;

xvi. On all Claims for Relief, assignment of Defendants' rights to seek refunds from the government for federal, state, and local taxes paid on Fictitious Profits during the courts of the scheme;

xvii. Awarding the Trustee all applicable interest, cots, and disbursements of this action; and

xviii. Granting Plaintiff such other, further, and different relief as the Court deems just, proper, and equitable.

Dated: New York, New York  
December 23, 2009

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of Bernard L. Madoff Investment Securities LLC  
and Bernard L. Madoff*

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

In re:

BERNARD L. MADOFF  
INVESTMENT SECURITIES LLC,

Debtor.

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

Plaintiff,

v.

J. EZRA MERKIN, GABRIEL CAPITAL, L.P.,  
ARIEL FUND LTD., ASCOT PARTNERS, L.P.,  
GABRIEL CAPITAL CORPORATION,

Defendants.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantively Consolidated)

Adv. Pro. No. 09-1182 (BRL)

**CERTIFICATE OF SERVICE**

I, NIKKI M. LANDRIO, hereby certify that on December 23, 2009, I served true copies of the **Second Amended Complaint** upon the interested parties who receive electronic service through ECF, by emailing the interested parties true and correct copies via electronic

transmission to the email addresses designated for delivery and/or by placing true and correct copies thereof in sealed packages designated for regular U.S. Mail to those parties as set forth on the attached Schedule A.

Dated: New York, New York  
December 23, 2009

*s/Nikki M. Landrio*  
NIKKI M. LANDRIO

**SCHEDULE A**

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New York, New York 10008

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Centralized Insolvency Operation  
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Washington, DC 20044

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**EXHIBIT A**

**Bernard L. Madoff Investment Securities, LLC**

**Summary of Defendants' Accounts Maintained with BLMIS**

<b>A/C#</b>	<b>Account Name</b>	<b>Opening Date</b>
1FN005	Ascot Fund Ltd	January 2, 1992
1A0058	Ascot Partners LP	January 4, 1993
1FR070	Ariel Fund Ltd	August 2, 2000
1G0321	Gabriel Capital LP	August 2, 2000

**EXHIBIT B**

**Bernard L. Madoff Investment Securities, LLC  
 Summary of Cash Transfers to Defendants**

For the Period from 12/1/95 - 12/11/08				
A/C#	Account Name	Date	Transfer	Amount
1A0058	ASCOT PARTNERS LP	12/28/1995	WIRE	6,000,000
1A0058	ASCOT PARTNERS LP	12/30/1996	WIRE	1,600,000
1A0058	ASCOT PARTNERS LP	1/7/1997	WIRE	9,240,000
1A0058	ASCOT PARTNERS LP	1/10/1997	WIRE	1,000,000
1A0058	ASCOT PARTNERS LP	10/8/1997	WIRE	2,500,000
1A0058	ASCOT PARTNERS LP	12/30/1997	WIRE	6,000,000
1A0058	ASCOT PARTNERS LP	1/7/1998	WIRE	2,500,000
1A0058	ASCOT PARTNERS LP	12/2/2003	WIRE	5,000,000
1A0058	ASCOT PARTNERS LP	12/26/2003	WIRE	12,000,000
1A0058	ASCOT PARTNERS LP	12/23/2005	WIRE	25,000,000
1A0058	ASCOT PARTNERS LP	1/6/2006	WIRE	63,000,000
1A0058	ASCOT PARTNERS LP	4/4/2006	WIRE	76,000,000
1A0058	ASCOT PARTNERS LP	12/29/2006	WIRE	10,000,000
1A0058	ASCOT PARTNERS LP	12/31/2007	WIRE	175,000,000
1A0058	ASCOT PARTNERS LP	7/2/2008	WIRE	50,000,000
1A0058	ASCOT PARTNERS LP	10/1/2008	WIRE	45,000,000
<b>SUBTOTAL</b>				<b>489,840,000</b>

1FN005	ASCOT FUND LTD	Dec-95	MONTHLY WITH AMT	74,554
1FN005	ASCOT FUND LTD	Jan-96	MONTHLY WITH AMT	21,515
1FN005	ASCOT FUND LTD	Feb-96	MONTHLY WITH AMT	3,786
1FN005	ASCOT FUND LTD	Mar-96	MONTHLY WITH AMT	69,268
1FN005	ASCOT FUND LTD	Apr-96	MONTHLY WITH AMT	25,642
1FN005	ASCOT FUND LTD	May-96	MONTHLY WITH AMT	42,506
1FN005	ASCOT FUND LTD	Jun-96	MONTHLY WITH AMT	37,099
1FN005	ASCOT FUND LTD	Jul-96	MONTHLY WITH AMT	40,172
1FN005	ASCOT FUND LTD	Aug-96	MONTHLY WITH AMT	43,226
1FN005	ASCOT FUND LTD	Sep-96	MONTHLY WITH AMT	83,522
1FN005	ASCOT FUND LTD	Oct-96	MONTHLY WITH AMT	23,118
1FN005	ASCOT FUND LTD	Nov-96	MONTHLY WITH AMT	13,623
1FN005	ASCOT FUND LTD	Dec-96	MONTHLY WITH AMT	72,736
1FN005	ASCOT FUND LTD	12/30/1996	WIRE	1,200,000
1FN005	ASCOT FUND LTD	1/7/1997	WIRE	7,240,000
1FN005	ASCOT FUND LTD	Jan-97	MONTHLY WITH AMT	24,541
1FN005	ASCOT FUND LTD	Feb-97	MONTHLY WITH AMT	4,608
1FN005	ASCOT FUND LTD	Mar-97	MONTHLY WITH AMT	71,540
1FN005	ASCOT FUND LTD	Apr-97	MONTHLY WITH AMT	7,416
1FN005	ASCOT FUND LTD	May-97	MONTHLY WITH AMT	22,593
1FN005	ASCOT FUND LTD	Jun-97	MONTHLY WITH AMT	14,962
1FN005	ASCOT FUND LTD	Jul-97	MONTHLY WITH AMT	20,826
1FN005	ASCOT FUND LTD	Aug-97	MONTHLY WITH AMT	31,411
1FN005	ASCOT FUND LTD	Sep-97	MONTHLY WITH AMT	9,545
1FN005	ASCOT FUND LTD	Oct-97	MONTHLY WITH AMT	50,607
1FN005	ASCOT FUND LTD	Nov-97	MONTHLY WITH AMT	38,280

**EXHIBIT B**

**Bernard L. Madoff Investment Securities, LLC  
 Summary of Cash Transfers to Defendants**

For the Period from 12/1/95 - 12/11/08				
A/C#	Account Name	Date	Transfer	Amount
1FN005	ASCOT FUND LTD	Dec-97	MONTHLY WITH AMT	10,986
1FN005	ASCOT FUND LTD	Jan-98	MONTHLY WITH AMT	15,040
1FN005	ASCOT FUND LTD	Feb-98	MONTHLY WITH AMT	5,266
1FN005	ASCOT FUND LTD	Mar-98	MONTHLY WITH AMT	83,396
1FN005	ASCOT FUND LTD	4/13/1998	WIRE	26,000,000
1FN005	ASCOT FUND LTD	Apr-98	MONTHLY WITH AMT	6,878
1FN005	ASCOT FUND LTD	May-98	MONTHLY WITH AMT	42,803
1FN005	ASCOT FUND LTD	Jun-98	MONTHLY WITH AMT	64,524
1FN005	ASCOT FUND LTD	Jul-98	MONTHLY WITH AMT	41,122
1FN005	ASCOT FUND LTD	Aug-98	MONTHLY WITH AMT	34,451
1FN005	ASCOT FUND LTD	Sep-98	MONTHLY WITH AMT	1,858
1FN005	ASCOT FUND LTD	Oct-98	MONTHLY WITH AMT	6
1FN005	ASCOT FUND LTD	Nov-98	MONTHLY WITH AMT	8
1FN005	ASCOT FUND LTD	Dec-98	MONTHLY WITH AMT	11,635
1FN005	ASCOT FUND LTD	Jan-99	MONTHLY WITH AMT	13,325
1FN005	ASCOT FUND LTD	Feb-99	MONTHLY WITH AMT	12,275
1FN005	ASCOT FUND LTD	Mar-99	MONTHLY WITH AMT	53,707
1FN005	ASCOT FUND LTD	Apr-99	MONTHLY WITH AMT	21,295
1FN005	ASCOT FUND LTD	May-99	MONTHLY WITH AMT	2,542
1FN005	ASCOT FUND LTD	Jun-99	MONTHLY WITH AMT	54,057
1FN005	ASCOT FUND LTD	Jul-99	MONTHLY WITH AMT	14,070
1FN005	ASCOT FUND LTD	Aug-99	MONTHLY WITH AMT	21,576
1FN005	ASCOT FUND LTD	Sep-99	MONTHLY WITH AMT	38,318
1FN005	ASCOT FUND LTD	Oct-99	MONTHLY WITH AMT	55,100
1FN005	ASCOT FUND LTD	Nov-99	MONTHLY WITH AMT	38,374
1FN005	ASCOT FUND LTD	Dec-99	MONTHLY WITH AMT	26,996
1FN005	ASCOT FUND LTD	Jan-00	MONTHLY WITH AMT	4
1FN005	ASCOT FUND LTD	Feb-00	MONTHLY WITH AMT	20,935
1FN005	ASCOT FUND LTD	Mar-00	MONTHLY WITH AMT	73,400
1FN005	ASCOT FUND LTD	Apr-00	MONTHLY WITH AMT	21,165
1FN005	ASCOT FUND LTD	May-00	MONTHLY WITH AMT	8
1FN005	ASCOT FUND LTD	Jun-00	MONTHLY WITH AMT	46,602
1FN005	ASCOT FUND LTD	Jul-00	MONTHLY WITH AMT	1,440
1FN005	ASCOT FUND LTD	Aug-00	MONTHLY WITH AMT	16,671
1FN005	ASCOT FUND LTD	Sep-00	MONTHLY WITH AMT	27,241
1FN005	ASCOT FUND LTD	Oct-00	MONTHLY WITH AMT	37,034
1FN005	ASCOT FUND LTD	Nov-00	MONTHLY WITH AMT	45,653
1FN005	ASCOT FUND LTD	Dec-00	MONTHLY WITH AMT	1,876
1FN005	ASCOT FUND LTD	Jan-01	MONTHLY WITH AMT	2,189
1FN005	ASCOT FUND LTD	Feb-01	MONTHLY WITH AMT	32,506
1FN005	ASCOT FUND LTD	Mar-01	MONTHLY WITH AMT	70,751
1FN005	ASCOT FUND LTD	Apr-01	MONTHLY WITH AMT	29,943
1FN005	ASCOT FUND LTD	May-01	MONTHLY WITH AMT	43,865
1FN005	ASCOT FUND LTD	Jun-01	MONTHLY WITH AMT	132
1FN005	ASCOT FUND LTD	Jul-01	MONTHLY WITH AMT	72,549

**EXHIBIT B**

**Bernard L. Madoff Investment Securities, LLC  
 Summary of Cash Transfers to Defendants**

For the Period from 12/1/95 - 12/11/08				
A/C#	Account Name	Date	Transfer	Amount
1FN005	ASCOT FUND LTD	Aug-01	MONTHLY WITH AMT	54,654
1FN005	ASCOT FUND LTD	Sep-01	MONTHLY WITH AMT	35,556
1FN005	ASCOT FUND LTD	Oct-01	MONTHLY WITH AMT	122,115
1FN005	ASCOT FUND LTD	Nov-01	MONTHLY WITH AMT	95,784
1FN005	ASCOT FUND LTD	Dec-01	MONTHLY WITH AMT	101,023
1FN005	ASCOT FUND LTD	Jan-02	MONTHLY WITH AMT	6,676
1FN005	ASCOT FUND LTD	Feb-02	MONTHLY WITH AMT	77,323
1FN005	ASCOT FUND LTD	Mar-02	MONTHLY WITH AMT	126,742
1FN005	ASCOT FUND LTD	Apr-02	MONTHLY WITH AMT	143,647
1FN005	ASCOT FUND LTD	May-02	MONTHLY WITH AMT	102,834
1FN005	ASCOT FUND LTD	Jun-02	MONTHLY WITH AMT	126,093
1FN005	ASCOT FUND LTD	Jul-02	MONTHLY WITH AMT	23,679
1FN005	ASCOT FUND LTD	Aug-02	MONTHLY WITH AMT	57,797
1FN005	ASCOT FUND LTD	Sep-02	MONTHLY WITH AMT	181,542
1FN005	ASCOT FUND LTD	Oct-02	MONTHLY WITH AMT	16
1FN005	ASCOT FUND LTD	Nov-02	MONTHLY WITH AMT	39,302
1FN005	ASCOT FUND LTD	Dec-02	MONTHLY WITH AMT	98,042
1FN005	ASCOT FUND LTD	Jan-03	MONTHLY WITH AMT	0
<b>SUBTOTAL</b>				<input type="checkbox"/> 37,893,497

1FR070	ARIEL FUND LTD	Aug-00	MONTHLY WITH AMT	<input type="checkbox"/> 11
1FR070	ARIEL FUND LTD	Sep-00	MONTHLY WITH AMT	16
1FR070	ARIEL FUND LTD	Oct-00	MONTHLY WITH AMT	5,041
1FR070	ARIEL FUND LTD	Nov-00	MONTHLY WITH AMT	6,198
1FR070	ARIEL FUND LTD	Dec-00	MONTHLY WITH AMT	275
1FR070	ARIEL FUND LTD	Jan-01	MONTHLY WITH AMT	329
1FR070	ARIEL FUND LTD	Feb-01	MONTHLY WITH AMT	6,852
1FR070	ARIEL FUND LTD	Mar-01	MONTHLY WITH AMT	15,957
1FR070	ARIEL FUND LTD	Apr-01	MONTHLY WITH AMT	6,429
1FR070	ARIEL FUND LTD	May-01	MONTHLY WITH AMT	9,391
1FR070	ARIEL FUND LTD	Jun-01	MONTHLY WITH AMT	115
1FR070	ARIEL FUND LTD	Jul-01	MONTHLY WITH AMT	17,778
1FR070	ARIEL FUND LTD	Aug-01	MONTHLY WITH AMT	13,429
1FR070	ARIEL FUND LTD	Sep-01	MONTHLY WITH AMT	8,581
1FR070	ARIEL FUND LTD	Oct-01	MONTHLY WITH AMT	29,585
1FR070	ARIEL FUND LTD	Nov-01	MONTHLY WITH AMT	23,123
1FR070	ARIEL FUND LTD	Dec-01	MONTHLY WITH AMT	24,381
1FR070	ARIEL FUND LTD	Jan-02	MONTHLY WITH AMT	1,781
1FR070	ARIEL FUND LTD	Feb-02	MONTHLY WITH AMT	20,554
1FR070	ARIEL FUND LTD	Mar-02	MONTHLY WITH AMT	33,538
1FR070	ARIEL FUND LTD	Apr-02	MONTHLY WITH AMT	37,979
1FR070	ARIEL FUND LTD	May-02	MONTHLY WITH AMT	27,190
1FR070	ARIEL FUND LTD	Jun-02	MONTHLY WITH AMT	32,065
1FR070	ARIEL FUND LTD	Jul-02	MONTHLY WITH AMT	5,992

**EXHIBIT B**

**Bernard L. Madoff Investment Securities, LLC  
 Summary of Cash Transfers to Defendants**

For the Period from 12/1/95 - 12/11/08				
A/C#	Account Name	Date	Transfer	Amount
1FR070	ARIEL FUND LTD	Aug-02	MONTHLY WITH AMT	14,055
1FR070	ARIEL FUND LTD	Sep-02	MONTHLY WITH AMT	43,484
1FR070	ARIEL FUND LTD	Oct-02	MONTHLY WITH AMT	25
1FR070	ARIEL FUND LTD	Nov-02	MONTHLY WITH AMT	9,049
1FR070	ARIEL FUND LTD	Dec-02	MONTHLY WITH AMT	22,600
1FR070	ARIEL FUND LTD	Jan-03	MONTHLY WITH AMT	1,187
1FR070	ARIEL FUND LTD	Feb-03	MONTHLY WITH AMT	34,797
1FR070	ARIEL FUND LTD	Mar-03	MONTHLY WITH AMT	41,371
1FR070	ARIEL FUND LTD	Apr-03	MONTHLY WITH AMT	6,221
1FR070	ARIEL FUND LTD	May-03	MONTHLY WITH AMT	922
1FR070	ARIEL FUND LTD	Jun-03	MONTHLY WITH AMT	45,523
1FR070	ARIEL FUND LTD	Jul-03	MONTHLY WITH AMT	29,798
1FR070	ARIEL FUND LTD	Aug-03	MONTHLY WITH AMT	36,358
1FR070	ARIEL FUND LTD	Sep-03	MONTHLY WITH AMT	32,370
1FR070	ARIEL FUND LTD	Oct-03	MONTHLY WITH AMT	17,344
1FR070	ARIEL FUND LTD	Nov-03	MONTHLY WITH AMT	39,773
1FR070	ARIEL FUND LTD	Dec-03	MONTHLY WITH AMT	39,768
1FR070	ARIEL FUND LTD	Jan-04	MONTHLY WITH AMT	4,785
1FR070	ARIEL FUND LTD	Feb-04	MONTHLY WITH AMT	20,309
1FR070	ARIEL FUND LTD	Mar-04	MONTHLY WITH AMT	31,787
1FR070	ARIEL FUND LTD	Apr-04	MONTHLY WITH AMT	2,053
1FR070	ARIEL FUND LTD	May-04	MONTHLY WITH AMT	24,412
1FR070	ARIEL FUND LTD	Jun-04	MONTHLY WITH AMT	38,590
1FR070	ARIEL FUND LTD	Jul-04	MONTHLY WITH AMT	13,383
1FR070	ARIEL FUND LTD	Aug-04	MONTHLY WITH AMT	61
1FR070	ARIEL FUND LTD	Sep-04	MONTHLY WITH AMT	28,367
1FR070	ARIEL FUND LTD	Oct-04	MONTHLY WITH AMT	22,115
1FR070	ARIEL FUND LTD	Nov-04	MONTHLY WITH AMT	570
1FR070	ARIEL FUND LTD	Dec-04	MONTHLY WITH AMT	25,717
1FR070	ARIEL FUND LTD	Jan-05	MONTHLY WITH AMT	915
1FR070	ARIEL FUND LTD	Feb-05	MONTHLY WITH AMT	16,042
1FR070	ARIEL FUND LTD	Mar-05	MONTHLY WITH AMT	69,667
1FR070	ARIEL FUND LTD	Apr-05	MONTHLY WITH AMT	33,109
1FR070	ARIEL FUND LTD	May-05	MONTHLY WITH AMT	43
1FR070	ARIEL FUND LTD	Jun-05	MONTHLY WITH AMT	16,017
1FR070	ARIEL FUND LTD	Jul-05	MONTHLY WITH AMT	29,623
1FR070	ARIEL FUND LTD	Sep-05	MONTHLY WITH AMT	1,753
1FR070	ARIEL FUND LTD	Oct-05	MONTHLY WITH AMT	27,842
1FR070	ARIEL FUND LTD	Nov-05	MONTHLY WITH AMT	25,532
1FR070	ARIEL FUND LTD	Dec-05	MONTHLY WITH AMT	78,651
1FR070	ARIEL FUND LTD	Jan-06	MONTHLY WITH AMT	18,505
1FR070	ARIEL FUND LTD	Feb-06	MONTHLY WITH AMT	39,535
1FR070	ARIEL FUND LTD	Mar-06	MONTHLY WITH AMT	113,685
1FR070	ARIEL FUND LTD	Apr-06	MONTHLY WITH AMT	58,681
1FR070	ARIEL FUND LTD	May-06	MONTHLY WITH AMT	73,171

**EXHIBIT B**

**Bernard L. Madoff Investment Securities, LLC  
 Summary of Cash Transfers to Defendants**

For the Period from 12/1/95 - 12/11/08				
A/C#	Account Name	Date	Transfer	Amount
1FR070	ARIEL FUND LTD	Jun-06	MONTHLY WITH AMT	111,315
1FR070	ARIEL FUND LTD	Jul-06	MONTHLY WITH AMT	39,474
1FR070	ARIEL FUND LTD	Aug-06	MONTHLY WITH AMT	34,144
1FR070	ARIEL FUND LTD	Sep-06	MONTHLY WITH AMT	121,270
1FR070	ARIEL FUND LTD	Oct-06	MONTHLY WITH AMT	50,855
1FR070	ARIEL FUND LTD	Nov-06	MONTHLY WITH AMT	28,977
1FR070	ARIEL FUND LTD	Dec-06	MONTHLY WITH AMT	179,390
1FR070	ARIEL FUND LTD	Jan-07	MONTHLY WITH AMT	56,400
1FR070	ARIEL FUND LTD	Feb-07	MONTHLY WITH AMT	21
1FR070	ARIEL FUND LTD	Mar-07	MONTHLY WITH AMT	78,287
1FR070	ARIEL FUND LTD	Apr-07	MONTHLY WITH AMT	74,535
1FR070	ARIEL FUND LTD	May-07	MONTHLY WITH AMT	48,815
1FR070	ARIEL FUND LTD	Jun-07	MONTHLY WITH AMT	205,980
1FR070	ARIEL FUND LTD	Jul-07	MONTHLY WITH AMT	34,487
1FR070	ARIEL FUND LTD	Aug-07	MONTHLY WITH AMT	12,683
1FR070	ARIEL FUND LTD	Sep-07	MONTHLY WITH AMT	45,275
1FR070	ARIEL FUND LTD	Oct-07	MONTHLY WITH AMT	28,361
1FR070	ARIEL FUND LTD	Nov-07	MONTHLY WITH AMT	9,370
1FR070	ARIEL FUND LTD	Dec-07	MONTHLY WITH AMT	36,240
1FR070	ARIEL FUND LTD	Jan-08	MONTHLY WITH AMT	4,119
1FR070	ARIEL FUND LTD	Feb-08	MONTHLY WITH AMT	11,381
1FR070	ARIEL FUND LTD	Mar-08	MONTHLY WITH AMT	123,989
1FR070	ARIEL FUND LTD	Apr-08	MONTHLY WITH AMT	48,738
1FR070	ARIEL FUND LTD	May-08	MONTHLY WITH AMT	46,423
1FR070	ARIEL FUND LTD	Jun-08	MONTHLY WITH AMT	126,053
1FR070	ARIEL FUND LTD	7/7/2008	WIRE	16,200,000
1FR070	ARIEL FUND LTD	Jul-08	MONTHLY WITH AMT	42
1FR070	ARIEL FUND LTD	Aug-08	MONTHLY WITH AMT	15,648
1FR070	ARIEL FUND LTD	Sep-08	MONTHLY WITH AMT	170,850
1FR070	ARIEL FUND LTD	Oct-08	MONTHLY WITH AMT	19,413
1FR070	ARIEL FUND LTD	Nov-08	MONTHLY WITH AMT	3
<b>SUBTOTAL</b>				<u>□ 19,518,697</u>
1G0321	GABRIEL CAPITAL LP	7/7/2008	WIRE	<u>□ 17,400,000</u>
<b>SUBTOTAL</b>				<u>□ 17,400,000</u>
<b>GRAND TOTAL</b>				<u>□ 564,652,194</u>

# **EXHIBIT F**

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**UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**

SECURITIES INVESTOR PROTECTIONS CORPORATION,  Plaintiff-Applicant.  - against -  BERNARD L. MADOFF INVESTMENT SECURITIES LLC,  Defendant.
In re:  BERNARD L. MADOFF INVESTMENT SECURITIES LLC,  Debtor.
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC,  Plaintiff,  - against -  J. EZRA MERKIN, GABRIEL CAPITAL, L.P., ARIEL FUND LTD., ASCOT PARTNERS, L.P., and GABRIEL CAPITAL CORP.,  Defendants.

Adv. Pro. No. 08-01789 (BRL)

SIPA LIQUIDATION

(Substantially Consolidated)

Adv. Pro. No. 09-1182 (BRL)

**MEMORANDUM OF LAW IN SUPPORT OF MOTION OF BART M. SCHWARTZ,  
AS RECEIVER OF DEFENDANTS ARIEL FUND LIMITED  
AND GABRIEL CAPITAL, L.P., TO WITHDRAW THE REFERENCE**

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Bart M. Schwartz, as Receiver (“Receiver”) of defendants Ariel Fund Limited (“Ariel”) and Gabriel Capital, L.P. (“Gabriel” and together with Ariel, the “Funds”) respectfully submits this memorandum of law in support of his motion, pursuant to 28 U.S.C. § 157(d), Rule 5011 of the Federal Rules of Bankruptcy Procedure, and Rule 5011-1 of the Local Rules of the Southern District of New York, to withdraw from the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”) the reference of this adversary proceeding (the “Adversary Proceeding”) brought against the Funds by Irving H. Picard, the trustee (the “Trustee”) for the liquidation of Bernard L. Madoff Investment Securities LLC (“BLMIS”).<sup>1</sup> In support of his motion, the Receiver respectfully states as follows:

#### **PRELIMINARY STATEMENT**

Through the Adversary Proceeding, the Trustee seeks to avoid, as fraudulent transfers, withdrawals made by the Funds of their principal investment from their brokerage accounts with BLMIS. The Trustee seeks to recover an aggregate of \$33 million that the Funds received from BLMIS, which represents less than 5% of the over \$300 million they invested with BLMIS and less than 10% of the amount reflected on the account statements they received in the months preceding BLMIS’ bankruptcy filing. By this motion, the Receiver requests that the District Court withdraw the reference of the Adversary Proceeding to resolve the same issues the District Court already has found on numerous prior occasions warrant withdrawing the reference in other BLMIS-related proceedings which have been brought by the Trustee.

Specifically, the Receiver submits that withdrawal of the reference with respect to the entirety of the Adversary Proceeding is warranted for two reasons. First, the fraudulent transfer

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<sup>1</sup> In addition to the claims against the Funds, the Trustee also has asserted claims in the Adversary Proceeding against Ascot Partners, L.P., J. Ezra Merkin and Gabriel Capital Corp.

claims asserted in the Trustee's complaint raise significant questions regarding the interpretation of the Securities Investor Protection Act ("SIPA") and other federal and state securities laws, including whether SIPA and applicable securities laws authorize the avoidance of redemption payments made to an investor of less than the amounts the investor deposited with BLMIS. The Adversary Proceeding also requires the District Court to determine whether SIPA can be interpreted to authorize a result that is inconsistent with a clearly applicable defense under Section 546(e) of the Bankruptcy Code.

In addition, given the United States Supreme Court's recent decision in *Stern v. Marshall*, the immediate withdrawal of this entire adversary proceeding for all purposes will avoid any Constitutional issues relative to the power of the Bankruptcy Court to enter final judgment in this matter. All of these issues must be resolved by the District Court. Indeed, the District Court has withdrawn the reference on identical grounds in at least four other BLMIS-related suits. The same result is warranted here.

## **BACKGROUND**

### **A. THE MADOFF PONZI SCHEME AND THE FUNDS**

#### **1. Madoff and BLMIS**

Bernard L. Madoff Investment Securities was a New York limited liability company registered with the SEC as a broker-dealer and, as of 2005, also as an investment adviser. *See* Memorandum Decision and Order Granting in Part and Denying In Part Defendants' Motions to Dismiss Trustee's Complaint, No. 09-1182, (Bankr. S.D.N.Y. November 17, 2011) (Hon. Burton R. Lifland) (the "Order") at 5 (a copy of which is attached as Exhibit A to the Declaration of John L. Scott in Support of Motion of Bart M. Schwartz, as Receiver of defendants Ariel Fund Limited and Gabriel Capital, L.P. to Withdraw the Reference, the "Scott Decl."). By virtue of its

registration as broker-dealer, BLMIS was a member of the Securities Investor Protection Corporation (“SIPC”), and it was run by its founder, Bernard L. Madoff (“Madoff”), along with several family members and other employees. *Id.* BLMIS was organized into three business units: the market making unit, the proprietary trading unit, and the investment advisory business. *Id.*

On December 11, 2008, Madoff was arrested by federal agents and charged with securities fraud. *Id.* at 4. Madoff pled guilty to all charges and is currently serving a 150 year prison sentence. Madoff’s fraudulent activity was perpetrated through BLMIS’ investment advisory unit. *Id.* at 5. To facilitate his fraud, Madoff generated customer account statements purportedly showing securities that either were held or had been traded, as well as the gains and losses in those accounts. However, as Madoff admitted in his plea hearing, the purported trades reflected in customers’ account statements never took place; rather, Madoff, along with some of his co-conspirators, fabricated the fake account statements and disseminated them to BLMIS’ numerous customers. *Id.* at 6.

On December 15, 2008, SIPC filed an application seeking a decree that the customers of BLMIS are in need of the protections afforded under the Securities Investor Protection Act of 1970 (“SIPA”) (15 U.S.C. §§ 78aaa et seq.). The District Court (Stanton, J.) granted SIPC’s application and entered an order on December 15, 2008, placing BLMIS’ customers under the protection of SIPA. That order appointed the Trustee as trustee for the liquidation of BLMIS’ business. *Id.* at 5. Judge Stanton’s order also provided, *inter alia*, for the transfer of the SIPA liquidation proceeding to the United States Bankruptcy Court for this District pursuant to 15 U.S.C. § 78eee(b)(4).

2. The Funds

The Funds are investment vehicles that pooled together investors' monies and made investments on their behalf. Ariel was incorporated in the Cayman Islands and was suitable for non-U.S. and U.S. tax-exempt investors. Gabriel was a Delaware partnership suitable for U.S. taxable investors. Other than that difference, the Funds followed substantially the same investment strategy and, for the most part, their investments were made *pari passu*. The Funds were managed by J. Ezra Merkin ("Merkin") and his investment advisory firm, Gabriel Capital Corporation ("GCC"). *See* Order at 6-7.

The Funds opened accounts with BLMIS at least as early as August 2000 and, in doing so, had executed a Customer Agreement, an Option Agreement, and a Trading Authorization Limited to Purchases and Sales of Securities and Options (collectively, the "Account Agreements") that enabled BLMIS to effectuate trades on their behalf. *Id.* at 7. Throughout the years of maintaining their BLMIS accounts, the Funds transmitted more than \$150 million each (for an aggregate of more than \$300 million) to be traded in accordance with their Account Agreements. *See* Declaration of Lance Gotthoffer in Support of Motion by Defendants Ariel Fund Limited and Gabriel Capital L.P. to Dismiss the Second Amended Complaint (of which Exhibits A-I and L-V are not included, a copy of which is attached as Exhibit B to the Scott Decl.). At the time of BLMIS' collapse, the Funds' account statements reflected a balance of approximately \$308 million each. *Id.*, Exhibit J–K. Throughout the years of maintaining their accounts, each of Ariel and Gabriel only submitted one withdrawal request. That occurred in June of 2008 (*i.e.*, 6 months before the fraud was revealed) – in the amount of \$16.2 million for Ariel and \$17.4

million for Gabriel – and represented only a small fraction of the Funds’ investment with BLMIS.<sup>2</sup>

**B. THE INSTANT ADVERSARY PROCEEDING**

In April 2009, the Trustee brought the Adversary Proceeding against the Funds. Thereafter, the Trustee’s complaint was amended to seek recovery of the two transfers made by BLMIS to the Funds (the “Transfers”) as actual and constructive fraudulent conveyances pursuant to the Bankruptcy Code and New York Debtor Creditor Law (“NYDCL”) (the “Complaint”, a copy of which is attached as Exhibit C to the Scott Decl.). In addition, the Trustee sought an accounting and immediate turnover of the Transfers, pursuant to Section 542 of the Bankruptcy Code, and to disallow the Funds’ customer claims in BLMIS’ SIPA liquidation proceeding.

In January 2010, the Funds moved to dismiss the Trustee’s claims. One of the primary arguments articulated by the Funds in support of dismissal was that the Trustee may not avoid the Transfers as constructive fraudulent conveyances under Section 548(A)(1)(B) because the Transfers were made by a stockbroker (BLMIS) to a financial institution (the Funds’ bank account at JP Morgan Chase) pursuant to the Funds’ securities contracts with BLMIS (*i.e.* the Account Agreements). As such, the Transfers fall within the “safe harbor” of Section 546(e) of the Bankruptcy Code which “precludes avoidance of transfers made in connection with a securities contract.” *See* Corrected Memorandum of Law in Support of Motion by Defendants Ariel Fund Limited and Gabriel Capital L.P. to Dismiss the Second Amended Complaint, dated January 25, 2010, at p. 27 (a copy of which is attached as Exhibit D to the Scott Decl.). The Funds

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<sup>2</sup> The Funds pointed the Trustee to documents in his possession which showed these redemptions were made to meet redemption requests from investors in the Funds. The Trustee never disputed this fact, but nevertheless continues to prosecute the Adversary Proceeding.

also argued that the Transfers were made in good faith for “value” and on account of an antecedent debt since the Funds held tort claim to recover 100% of the amount of their principal investment based on BMLIS’s fraud, and therefore they cannot even be recovered as actual fraudulent conveyances under Section 548(a)(1)(A) of the Bankruptcy Code – otherwise the sole exception to the safe harbor of Section 546(e). *Id.* at pp. 12-13; *see also id.* at pp. 29-30.

On November 17, 2010, Judge Lifland issued an order finding that the Trustee had not adequately stated a claim for the immediate turnover of funds and accounting under section 542 of the Bankruptcy Code. The Bankruptcy Court found that the Trustee’s other claims were adequately alleged and allowed them to proceed. Notably for purposes of this motion, the Bankruptcy Court considered and rejected the Funds’ Section 546(e) defense as “at best premature,” but noted that application of Section 546(e) to the Transfers would be “contrary to the purpose of the safe harbor provision and incompatible with SIPA.” *See* Order at pp. 31, 33.

On August 31, 2011, Judge Wood of the United States District Court for the Southern District of New York (the “District Court”) denied the Receiver’s motion for leave to appeal the Bankruptcy Court’s decision, finding that the Receiver had not established a substantial ground for disputing the correctness of the standards applied by the Bankruptcy Court. *See* Order, Case No. 11-00012 (S.D.N.Y. August 31, 2011) (Hon. Kimba M. Wood), pp. 10, 15, 18, 23, 25 (a copy of which is attached as Exhibit E to the Scott Decl.). The parties in the Adversary Proceeding currently are engaged in fact discovery, but depositions have not yet been scheduled.

**C. THE BANKRUPTCY COURT’S ORDER ESTABLISHING  
A DEADLINE FOR WITHDRAWING THE REFERENCE**

On March 5, 2012, the Bankruptcy Court entered an administrative order establishing April 2, 2012 as the deadline for filing a motion to withdraw the reference on the basis of issues arising in any adversary proceeding which has been commenced by the Trustee. Administrative

Order Establishing Deadline For Filing Motions to Withdraw the Reference, dated March 5, 2012 (“Administrative Order”) (a copy of which is attached as Exhibit F to the Scott Decl.). Judge Lifland noted in the Administrative Order that motions to withdraw the reference have already been filed in over 400 such proceedings.

## ARGUMENT

The fraudulent transfer claims asserted in the Adversary Proceeding warrant withdrawal of the reference by the District Court. Indeed, withdrawal of the reference is mandatory under 28 U.S.C. § 157(d) because the resolution of the claims in the Complaint require the consideration of fundamental issues regarding the interpretation of SIPA, other federal securities laws, and their interaction with the Bankruptcy Code. Resolution of these issues will directly affect the resolution of this case and likely will affect all of the cases brought by the Trustee against BLMIS customers. Accordingly, for the reasons set forth below, the Receiver respectfully requests that the District Court withdraw the reference of the Adversary Proceeding.

### I. WITHDRAWAL OF THE REFERENCE IS MANDATORY

Section 157(d) of Title 28 of the United States Code provides:

The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that *resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.*

28 U.S.C. § 157(d) (emphasis added).

Pursuant to 28 U.S.C. § 157(d), the District Court may *sua sponte* withdraw the reference for “a wide variety of reasons.” *Picard v. HSBC Bank PLC*, 450 B.R. 406, 409 (S.D.N.Y. 2011). The nature of the questions raised by the Trustee in the Adversary Proceeding, and their application to the BLMIS case generally, constitute such a reason. *See, e.g., In re Chateaugay*

*Corp.*, 86 B.R. 33, 36-39 (S.D.N.Y. 1987) (finding mandatory and permissive withdrawal of core bankruptcy claims appropriate because claims involved significant issues of first impression of bankruptcy and ERISA law that could impact many present and future retirees and their employers). In addition, “a litigant can mandate withdrawal of the bankruptcy reference where the movant shows that, absent the withdrawal, the bankruptcy judge would be obliged ‘to engage in significant interpretation, as opposed to simple application, of federal laws apart from the bankruptcy statute.’” *HSBC*, 450 B.R. at 409 (citing *City of New York v. Exxon Corp.*, 932 F.2d 1020, 1026 (2d Cir. 1991)); see also *Picard v. JP Morgan Chase & Co.*, 454 B.R. 307, 312 (S.D.N.Y. 2011) (same); *Enron Power Mktg., Inc. v. Cal. Power Exch. Corp. (In re Enron Corp.)*, No. 04 Civ. 8177, 2004 WL 2711101, at \*2 (S.D.N.Y. Nov. 23, 2004) (holding that the reference of any proceeding that involves “substantial and material consideration” of non-bankruptcy federal law must also be withdrawn) (quoting *Shugrue v. Air Line Pilots Ass’n Int’l (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 995 (2d Cir. 1990)).

Thus, where significant interpretation of the securities laws has been required, withdrawal has been found to be mandatory. See, e.g., *Bear, Stearns Sec. Corp. v. Gredd*, No. 01 CIV 4379, 2001 WL 840187, at \*4 (S.D.N.Y. July 25, 2001) (withdrawal mandatory where SEC rule potentially precluded application of the Bankruptcy Code avoidance provisions because debtor would not have an interest in the subject property); *In re Cablevision S.A.*, 315 B.R. 818, 821 (S.D.N.Y. 2004) (withdrawal mandatory where the interplay between the federal securities laws and the ancillary proceeding section of the Bankruptcy Code was required); *In re Enron Corp.*, 388 B.R. 131, 140 (S.D.N.Y. 2008) (withdrawal mandatory where trustee’s theory of secondary liability under Section 550(a)(1) of the Bankruptcy Code, if it were reached, involved substantial and material consideration of the Securities Act). Mandatory withdrawal also is

required where there appears to be a conflict between the Bankruptcy Code and other federal laws. *See HSBC*, 460 B.R. at 412 (deeming a conflict between SIPA and bankruptcy law as “something that itself warrants withdrawal of the bankruptcy reference”); *see also In re Cablevision*, 315 B.R. at 821 (“The very existence of a dispute as to whether the rights of [investors] under the [Trust Indenture Act] and Williams Act supersede Section 304 [of the Bankruptcy Code] or whether the Bankruptcy Code overrides the TIA, regardless of the ultimate resolution of such dispute, mandates withdrawal.”); *Gredd*, 2001 WL 840187, at \*2-4 (withdrawing reference where federal securities laws “arguably conflict[ed]” with the Bankruptcy Code).

As set forth below, the resolution of the Adversary Proceeding requires the interpretation of significant issues regarding the scope of the Trustee’s authority under SIPA and its effect on other federal laws, including the Bankruptcy Code. As such, withdrawal of the reference is mandated and appropriate. Indeed, because SIPA is codified under Title 15 as a securities law, a “substantial issue under SIPA is therefore, almost by definition, an issue ‘the resolution of [which] requires consideration of both title 11 and other laws of the United States.’” *HSBC*, 450 B.R. at 410 (quoting 28 U.S.C. § 157(d)). As the District Court instructed in another BLMIS-related proceeding:

[A]n issue that requires significant interpretation of SIPA undoubtedly requires consideration of laws other than Title 11. Regardless of a bankruptcy court’s familiarity with a statute outside of Title 11, the requirements for mandatory withdrawal are satisfied if the proceeding requires consideration of a law outside of Title 11.

*JP Morgan Chase*, 454 B.R. at 316.

The Trustee contends in the Adversary Proceeding that SIPA must be interpreted to expand the avoidance powers of the Trustee. *See* Trustee’s Memorandum of Law in Opposition to Motion by Defendants Ariel Fund Ltd. and Gabriel Capital L.P. to Dismiss the Second

Amended Complaint, p. 41-42 (the “Trustee’s Memo,” a copy of which is attached as Exhibit G to the Scott Decl.). However, the plain language of SIPA is contrary to this interpretation. SIPA provides that a SIPA trustee may employ the avoidance provisions only “if and to the extent that [a] transfer is voidable or void under the provisions of title 11.” 15 U.S.C. § 78fff-2(c)(3). The Trustee’s Complaint requires an unprecedented, expanded reading of SIPA that conflicts with the Bankruptcy Code and with non-SIPA securities law. Such an interpretation mandates withdrawal of the reference.

**II. THE TRUSTEE’S ARGUMENT THAT SIPA NEGATES BANKRUPTCY CODE SECTION 546(E) WARRANTS WITHDRAWING THE REFERENCE**

Section 546(e) of the Bankruptcy Code sets limitations on the Trustee’s ability to avoid certain transfers. *See* 11 U.S.C. § 546(e). Recognizing that he cannot proceed with his constructive fraudulent conveyance claim against the Funds if this “safe harbor” provision applies, the Trustee has argued that SIPA overrides Section 546(e) here. *See* Trustee’s Memo p. 35-36. Since resolution of this issue requires an interpretation of SIPA that is inconsistent with the Bankruptcy Code, withdrawal of the reference is mandated. *See HSBC*, 460 B.R. at 413 (holding that a conflict between SIPA and bankruptcy law “warrants withdrawal of the bankruptcy reference”).

Section 546(e) of the Code provides that a “trustee may not avoid a transfer . . . that is a transfer made by or to . . . [a] stockbroker [or] financial institution . . . in connection with a securities contract . . . .” *Id.* Section 546(e) is one of several Bankruptcy Code provisions that provide a wide range of safe harbors that balance the avoidance powers with the need to protect the securities and financial markets from disruption. However, Section 546(e) does not apply to insulate an actual fraudulent conveyance made within two years of a bankruptcy filing unless the recipient received the transfer in good faith and for “value.”

Section 741(7) defines the term “securities contract” broadly to include “a contract for the purchase [or] sale ... of a security ..., including an option to purchase or sell any security.” 11 U.S.C. § 741(7)(A)(i). Further, the term “settlement payment,” which also is defined broadly, includes “any payment in settlement of a securities transaction.” *In re Enron Creditors Recovery Corp.*, 422 B.R. 423, 433-434 (S.D.N.Y. 2009); 11 U.S.C. § 741(8). *See, generally, In re Stewart Finance Co.*, 367 B.R. 909, 917 (Bankr. M.D. Ga. 2007) (“As suggested by this definition, the term ‘settlement payment’ should be interpreted very broadly.”).<sup>3</sup> Finally, the Bankruptcy Code defines the term “stockbroker” as a person “with respect to which there is a customer” and “that is engaged in the business of effecting transactions in securities for the account of others ...,” 11 U.S.C. § 101(53A), and the term “financial institution” as “an entity that is a commercial or savings bank ...” 11 U.S.C. § 101(22). Applying the plain language of these sections here, it is clear that all of the elements of Section 546(e) are satisfied, and therefore this section of the Bankruptcy Code serves as a complete bar to the Trustee’s constructive fraudulent conveyance claims against the Funds.

First, BLMIS was, and must have been, a “broker” within the meaning of Section 546(e) because, among other things, it is the subject of a SIPA proceeding. Only a registered broker qualifies as a candidate for a SIPA proceeding. *See* 15 U.S.C. § 78ccc(a)(2)(A) (defining SIPC members as registered brokers or dealers under the federal securities laws). If BLMIS was a broker under applicable law when it engaged in the targeted transfers and was a broker for purposes of a SIPA liquidation, to conclude that BLMIS is not a broker for purposes of the

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<sup>3</sup> Notably, the *Enron Creditors Recovery* court recognized that “section 741(8) does not limit the definition of ‘settlement payment’ to payments ‘commonly used in the securities trade.’ ” 422 B.R. at 430.

Bankruptcy Code safe harbor in a SIPA case creates a mystifying conflict among SIPA, the securities laws, and the Bankruptcy Code.

In addition, as even the Trustee concedes in his Complaint, BLMIS and the Funds “executed a Customer Agreement, an Option Agreement, and a Trading Authorization Limited to Purchases and Sales of Securities and Options” for purposes of “securities trading activities.” Complaint at ¶¶ 38-39. The Trustee alleges further that “Defendants consistently wired funds to the BLMIS Bank Account in New York, New York for application to the Account[s] and the conducting of trading activities.” *Id.* at ¶ 39. Thus, it is beyond dispute that the Transfers were made in connection with a “securities contact” as contemplated by Section 546(e). It also cannot be disputed that JP Morgan Chase, the bank from which BLMIS wired the Transfers to the Funds, is a “financial institution.” Accordingly, all of Section 546(e)’s requirements are satisfied here.

Nevertheless, the Trustee has maintained in the Adversary Proceeding that application of Section 546(e) is “inconsistent with SIPA and inapplicable here” because it would allow the Funds “to circumvent one of the core foundations of the Bankruptcy Code and SIPA – that is, the equitable distribution of assets of all similarly-situated creditors.” *See* Trustee’s Memo, p. 33-34, 36. In fact, the Trustee maintains that permitting the Funds to benefit from the protections afforded by Section 546(e) “would run afoul of the equitable principles underlying SIPA ...[by] significantly diminish[ing] the assets available to the Trustee for equitable distribution to *all* customers of BLMIS who were harmed by the fraud.” *Id.* at p. 34. This novel interpretation of

SIPA which directly conflicts with the Bankruptcy Code warrants withdrawing the Bankruptcy Court reference. *See HSBC*, 450 B.R. at 412.<sup>4</sup>

Notably, the District Court recently found that it was required to withdraw the reference in *Picard v. Katz* to resolve this precise issue – *i.e.*, whether SIPA limits the applicability of Section 546(e) in an adversary proceeding brought by the Trustee. *See Picard v. Katz*, No. 11 Civ. 3605, 2011 WL 7267859, at \*1 (S.D.N.Y. July 5, 2011) (referencing the Court’s July 1, 2011 hearing). In so doing, the Court found that resolution of this issue involved “material and unresolved issues of non-bankruptcy federal law.” *Id.* Accordingly, the *Katz* court withdrew the reference.<sup>5</sup>

The District Court likewise found that it was required to withdraw the reference in *Picard v. Flinn Investments, LLC*, to decide whether Section 546(e) limits the Trustee’s ability to avoid transfers. 463 B.R. 280, 285 (S.D.N.Y. 2011). Indeed, the *Flinn* court agreed that whether Section 546(e) applies depends on how a Court resolves numerous questions of securities law, including, “whether transfers from Madoff Securities completed securities transactions even though Madoff Securities never purchased or sold securities on these defendants’ behalves.” 463 B.R. at 285. The Court held that making this determination requires a “*significant interpretation*” of securities law. *Id.* (emphasis added) In addition, the Court found that the

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<sup>4</sup> The Bankruptcy Court previously has held that application of Section 546(e) to a BLMIS adversary proceeding was “incompatible with SIPA” and, therefore, SIPA controls and Section 546(e) cannot apply. *Picard v. Merkin*, 440 B.R. 243, 267-68 (Bankr. S.D.N.Y. 2010).

<sup>5</sup> Thereafter, on September 1, 2011, Judge Rakoff granted, in part, the *Katz* defendants’ motion to dismiss, finding that: (i) Section 546(e)’s safe harbor for settlement payments and transfers made in connection with securities contract barred the Trustee from proceeding with claims to recover monies paid by BLMIS to its customers, except in cases of actual fraud; (ii) prepetition transfers by BLMIS could not be avoided as actual fraudulent transfers, absent bad faith on part of customers, to the extent that customers invested principal with, and thus gave value to, BLMIS; and (iii) SIPA barred the Trustee’s disallowance claims. *See Picard v. Katz*, 462 B.R. 447 (S.D.N.Y. 2011).

phrase, “in connection with,” as used in Section 546(e) to discuss securities contracts, is not defined in the Bankruptcy Code, and therefore application of the phrase also requires novel and significant interpretation of the securities law. *Id.* at 285-286. Accordingly, the Court withdrew the reference to decide the question of Section 546(e)’s application in a SIPA proceeding. *Id.* at 286.

The District Court’s reasoning in *Katz* and *Flinn* is sound. Accordingly, the same result is warranted here.

### **III. THE INTERPRETATION OF SIPA TO AUTHORIZE THE AVOIDANCE OF PRINCIPAL PAYMENTS TO BLMIS CUSTOMERS FURTHER REQUIRES WITHDRAWING THE REFERENCE**

As this Court is well aware, under the Bankruptcy Code, certain transfers occurring prior to a bankruptcy filing may be avoided either as fraudulent or as preferential transfers. Of relevance here, a transfer is intentionally fraudulent when the debtor “intends to hinder and delay [its creditors] *as a class.*” *Van Iderstine v. Nat’l Discount Co.*, 227 U.S. 575, 582 (1913) (emphasis added). A transfer that has the same result, even if not intentional, is avoidable as constructively fraudulent. “Fraudulent transfers are avoidable because they diminish the assets of the debtor to the detriment of *all creditors.*” *In re Chase & Sanborn Corp.*, 813 F.2d 1177, 1181 (11th Cir. 1987) (emphasis added). Nevertheless, the trustee cannot avoid transfers made for “value” and received in “good faith.”

In the context of redemption payments received by an investor of less than its principal investment from an entity operating a fraudulent Ponzi scheme, “value” for such payment is sufficiently established because the investors holds a tort claim for rescission to recover 100% of the amount of its investment based on the pervasive and continuing fraud that induced its investment. *In re Bayou Group, LLC*, 396 B.R. 810, 844 (Bankr. S.D.N.Y. 2008); *see also Donell v. Kowell*, 533 F. 3d 762, 772 (9th Cir. 2008), *cert. denied Kowell v. Donell*, 129 S.Ct.

640 (2008) (“Payments up to the amount of the initial investment are considered to be exchanged for ‘reasonably equivalent value,’ and thus not fraudulent, because they proportionally reduce the investors’ right to restitution.”). It is undisputed here that the Funds did not withdraw any amounts in excess of their investments, so there can be no argument that the Funds received false profits. To the contrary, the Funds withdrew less than 10% of the amount they invested.

Moreover, by definition, a transfer to a creditor that discharges a valid debt – such as BLMIS’ transfers to customers – cannot be avoided as fraudulent. As the Second Circuit consistently has recognized, “the preferential repayment of pre-existing debts to some creditors does not constitute a fraudulent conveyance, whether or not it prejudices other creditors, because ‘the basic object of fraudulent conveyance law is to see that the debtor uses his limited assets to satisfy *some* of his creditors; it normally does not try to choose among them.’” *HBE Leasing Corp. v. Frank*, 48 F.3d 623, 634 (2d Cir. 1995) (quoting *Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1509 (1st Cir. 1987)); *see also In re Sharp Int’l Corp.*, 403 F.3d 43, 54 (2d Cir. 2005) (“‘[A] conveyance which satisfies an antecedent debt made while the debtor is insolvent is neither fraudulent nor otherwise improper, even if its effect is to prefer one creditor over another.’” (quoting *Ultramar Energy Ltd. v. Chase Manhattan Bank, N.A.*, 191 A.D. 2d 86, 90-91, 599 N.Y.S. 2d 816 (1st Dep’t 1993))).

For example, in *In re Sharp International Corp.*, 403 F. 3d 43 (2d Cir. 2005), the Second Circuit expressly held that a transfer made to satisfy an antecedent obligation to the debtor’s lender was not a fraudulent conveyance. In *Sharp*, the debtor sued one of its former lenders to recover a prepetition loan repayment the debtor made to the lender as, *inter alia*, an intentional fraudulent conveyance. The debtor argued that although it was current in its loan repayments to the lender, the lender arranged to have the debtor’s principals repay the lender’s loan, after the

lender began to suspect fraud, from the proceeds of new loans from unsuspecting lenders. The debtor thereafter obtained an additional \$25 million in financing from its noteholders and used those funds to pay the lender approximately \$12.25 million. Notably, the complaint alleged that the lender “gave no warnings and blew no whistles” and “ignored inquiring calls from the Noteholders.” *Id.* at 48.

On appeal from the district court’s decision affirming the bankruptcy court’s dismissal of the complaint, the Second Circuit found that “[t]he \$12.25 million payment was at most a preference between creditors and did not ‘hinder, delay, or defraud either present or future creditors.’” *Id.* at 56 (citing NYDCL § 276). In so holding, the Court recognized that “[a] conveyance which satisfies an antecedent debt made while the debtor is insolvent is neither fraudulent nor otherwise improper, even if its effect is to prefer one creditor over another.” *Id.* at 54-55. Importantly, the *Sharp* court held that although the essence of the complaint was that the lender “knew that there would likely be victims of the [principals]’ fraud, and arranged not to be among them” – which the court suggested was “repugnant” – the Court nevertheless concluded that “[t]he moral analysis contribute[d] little” and affirmed the dismissal. *Id.* at 52.

The Trustee does not dispute this proposition. The rationale articulated by the Trustee for avoiding the Transfers, however, is that the Funds did not, in fact, have tort claims against BLMIS since they allegedly were aware of the fraud. *See* Trustee’s Memo, p. 12-14. Consideration of this issue – *i.e.*, whether the Funds held tort claims against BLMIS under applicable securities laws – necessarily requires that the Court engage in significant interpretation of non-bankruptcy law, and warrants withdrawing the reference. Recently, in *Flinn*, the District Court agreed with the proposition propounded here by the Funds and found that, “[r]esolution of the issues this argument raises requires ‘significant interpretation’ of the

securities laws,” and therefore “withdr[ew] the reference to the bankruptcy court in order to undertake the ‘significant interpretation’ of securities law necessary to resolve it.” 463 B.R. at 285 (withdrawing the reference to determine whether BLMIS customer had rescission claim that was satisfied by transfer under applicable securities laws).

The District Court also should withdraw the reference of the Adversary Proceeding to determine whether the Funds acted in “good faith” when they received the Transfers. The standard applicable in bankruptcy avoidance actions is whether the defendant was on “inquiry notice” of the fraud, but nevertheless failed to diligently investigate. *See, e.g. In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 22-23 (S.D.N.Y. 2007); *In re Bayou Group, LLC*, 439 B.R. 284, 309 (S.D.N.Y. 2010). This Court found in another BLMIS-related adversary proceeding that the standard for “good faith” in a SIPA case, however, is not inquiry notice, but instead “willful blindness,” a much higher hurdle for the Trustee. *Picard v. Katz*, 462 B.R. 447, 455-456. Specifically, the Court held that an investor “has no inherent duty to inquire about his stockbroker” but that if an investor “intentionally chooses to blind himself to the ‘red flags’ that suggest a high probability of fraud, his ‘willful blindness’ . . . is tantamount to a lack of good faith.” *Id.* at 455. Nothing in the allegations in the Complaint suggests that the Trustee can prove willful blindness in this case. In any event, the Receiver submits that the District Court should withdraw the reference to consider whether the willful blindness standard applies for purposes of determining the Funds’ good faith.

#### **IV. ALLOWING THE ADVERSARY PROCEEDING TO REMAIN IN BANKRUPTCY COURT RAISES CONSTITUTIONAL ISSUES**

Withdrawal of the reference is also warranted because, in light of the Supreme Court’s recent decision in *Stern v. Marshall*, 131 S.Ct. 2594 (June 23, 2011), there is now a serious

question as to whether the Bankruptcy Court can constitutionally decide this Adversary Proceeding.

In *Stern*, the Supreme Court held that a counterclaim asserted by Vickie Marshall as debtor in possession was a core claim as defined in 28 U.S.C. § 157(b)(2) because it came within the category enumerated in section 157(b)(2)(C) – *i.e.*, “counterclaims by the estate against persons filing claims against the estate.” 131 S.Ct. at 2596. The Court nonetheless held that permitting a bankruptcy court to hear and determine the counterclaim would violate Article III of the Constitution because a bankruptcy court is not an Article III court and the counterclaim did not involve a “public right” that may be adjudicated by a non-Article III court. The Court held that the assertion of core jurisdiction under section 157(b)(2)(C), although in accord with the statute, was unconstitutional because the debtor’s “claim is a state law action independent of the federal bankruptcy law and not necessarily resolved by a ruling on the creditor’s proof of claim in bankruptcy.” 131 S.Ct. at 2611.

The Supreme Court also implied that fraudulent conveyance claims like those asserted in the Adversary Proceeding may not be heard by a Bankruptcy Court. Although the Court declined to rule on whether fraudulent conveyance claims may be decided by a non-Article III court in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), the *Stern* Court nevertheless relied on that decision as demonstrating the nature of the claims that may not be decided by a non-Article III court. In explaining why Vickie Marshall’s counterclaim could not be decided by a non-Article III court, Chief Justice Roberts explained:

In *Granfinanciera* we rejected a bankruptcy trustee’s argument that a fraudulent conveyance action filed on behalf of a bankruptcy estate against a noncreditor in a bankruptcy proceeding fell within the “public rights” exception. We explained that, “[i]f a statutory right is not closely intertwined with a federal regulatory program Congress has power to enact, and if that right neither belongs to nor exists against the Federal Government, then it must be adjudicated by an Article

III court.” *Id.* at 54-55. We reasoned that fraudulent conveyance suits were “quintessentially suits at common law that more nearly resemble state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors’ hierarchically ordered claims to a pro rata share of the bankruptcy res.” *Id.* at 56. As a consequence, we concluded that fraudulent conveyance actions were “more accurately characterized as a private rather than a public right as we have used those terms in our Article III decisions.” *Id.* at 55.

Vickie’s counterclaim—like the fraudulent conveyance claim at issue in *Granfinanciera*—does not fall within any of the varied formulations of the public rights exception in this Court’s cases.

131 S.Ct. at 2614.

The Court’s recognition that the distinction between public and private rights that it applied in *Granfinanciera* is determinative of whether a case can be decided by a bankruptcy court supports the conclusion that this entire Adversary Proceeding should be heard by the District Court. The presumption in favor of Article III courts clearly articulated by the majority in *Stern* weighs heavily in favor of immediate withdrawal of the reference of this Adversary Proceeding to the District Court for all purposes.

The District Court recently withdrew the reference in the Trustee’s action against Flinn Investments for this reason. *Flinn*, 463 B.R. at 287. The Court concluded that determining whether the final resolution of claims to avoid transfers as fraudulent requires an exercise of “judicial Power,” reserved for Article III courts, will require “significant interpretation” of both Article III and Supreme Court precedent. *Id.* at 287-288. As such, the Court withdrew the reference for the purpose of determining whether the bankruptcy court lacks the requisite “judicial Power” and “whether, if the bankruptcy court cannot finally resolve the fraudulent transfer claims in *Flinn*, it has the authority to render findings of fact and conclusions of law before final resolution.” *Id.* at 288.<sup>6</sup> The same result should apply here.<sup>7</sup>

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<sup>6</sup> The District Court has not yet rendered a decision on this issue.

**CONCLUSION**

For the reasons set forth above, this Adversary Proceeding should be heard the District Court for all purposes. Accordingly, it is respectfully submitted that the Withdrawal Motion should be granted.

Dated: April 2, 2012  
New York, New York

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<sup>7</sup> The Receiver recently learned that, on March 28, 2012, Judge Rakoff directed the Trustee to prepare a consent order, *inter alia*, granting all currently pending motions to withdraw the reference in order to address *Stern v. Marshall* issues. The Receiver will proceed in accordance with any such order in connection with *Stern v. Marshall* issues.

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UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

SECURITIES INVESTOR PROTECTION  
CORPORATION,

Plaintiff,

v.

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

Adv. Pro. No. 08-01789 (BRL)

SIPA Liquidation

(Substantively Consolidated)

In re:

BERNARD L. MADOFF,

Debtor.

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

Plaintiff,

v.

J. EZRA MERKIN, GABRIEL CAPITAL, L.P.,  
ARIEL FUND LTD., ASCOT PARTNERS, L.P.,  
GABRIEL CAPITAL CORPORATION,

Defendants.

Adv. Pro. No. 09-01182 (BRL)

**JOINDER OF DAVID B. PITOFSKY, AS RECEIVER FOR DEFENDANT  
ASCOT PARTNERS L.P., TO THE MOTION OF BART M. SCHWARTZ,  
AS RECEIVER OF DEFENDANTS ARIEL FUND LIMITED AND  
GABRIEL CAPITAL, L.P., TO WITHDRAW THE REFERENCE**

David B. Pitofsky, Esq., as Receiver (the “Receiver”) for defendant Ascot Partners L.P. (“Ascot”),<sup>1</sup> by his attorneys, Goodwin Procter LLP, respectfully joins in the Motion of Bart M. Schwartz, As Receiver of Defendants Ariel Fund Limited and Gabriel Capital, L.P., to Withdraw the Reference, filed on April 2, 2012 (Adv. Pro. Dkt. No. 119) and the concurrently filed memorandum of law and declaration in support thereof (Adv. Pro. Dkt. Nos. 120 and 121) (together, the “Schwartz Motion”). The Complaint in the within adversary proceeding raises issues as to Ascot substantially similar to those addressed in the Schwartz Motion that this Court has determined, in similar cases, require consideration of title 11 and substantial and material consideration of federal non-bankruptcy law.

**Background**

1. Ascot Fund Ltd. (“Ascot Fund”) opened an account in 1992 and Ascot opened a BLMIS account in 1993. In 2003, Ascot Fund transferred its account balance to the account held by Ascot in exchange for a limited partnership interest in Ascot. Over the life of Ascot’s account, approximately \$560 million was deposited in the account; however, the Trustee asserts that the transfers included \$335 million in fictitious profits embedded in the transferred accounts, leaving net cash deposited of approximately \$226 million. *See* Exhibits B and C to

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<sup>1</sup> On April 6, 2009, the New York State Attorney General filed a Summons and Complaint against J. Ezra Merkin (“Merkin”) and Gabriel Capital Corporation (“GCC” and together with Merkin, the “Merkin Defendants”) in the Supreme Court of the State of New York, New York County in the case of *People of the State of New York v. J. Ezra Merkin et al.* (Civ. No. 450879/2009) (Lowe, J.S.C.). The Summons and Complaint also named, among other entities, Ascot, Ariel Fund Limited (“Ariel”) and Gabriel Capital, L.P. (“Gabriel”) as defendants (the “Funds”). The Summons and Complaint seek, among other things, an accounting of transfers to the Funds. David Pitofsky is the Court-appointed Receiver for Ascot pursuant to a Stipulation and Order Appointing the Receiver dated July 14, 2009.

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Amended Complaint (Adv. Pro. Dkt. No. 10).<sup>2</sup> Additionally, Ascot withdrew \$489,840,000 and transferred \$129,400,000 out to other BLMIS accounts. *See* Exhibits B and C to Amended Complaint. In April 2009, Irving H. Picard, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC (“Trustee”, “BLMIS”) filed the Complaint against Merkin, Ascot, Ariel and Gabriel (Adv. Pro. Dkt. No. 1). The Trustee subsequently filed the Amended Complaint and the Second Amended Complaint (Adv. Pro. Dkt. Nos. 10 and 49). The Complaint was brought pursuant to sections 78fff(b) , 78fff-1(a) and 78fff-2(c)(3) of SIPA (15 U.S.C. §78aaa, *et seq.*), sections 105(a), 542, 544, 547, 548(a), 550(a) and 551 of the Bankruptcy Code (11 U.S.C. §101, *et seq.*) and the New York Fraudulent Conveyance Act (New York Debtor and Creditor Law §270, *et seq.*).

2. The Second Amended Complaint sought to avoid and recover approximately \$461 million from Ascot denominated as “Six Year Transfers”, including approximately \$235 million denominated as “Two Year Transfers” and \$35 million denominated as a “90 Day Transfer.” The 90 Day Transfer was allegedly avoidable and recoverable pursuant to SIPA section 78fff-2(c)(3) and section 547(b) and 550(a)(1) of the Bankruptcy Code and could be preserved for the benefit of the estate under section 551 of the Bankruptcy Code. The Two-Year Transfers were allegedly avoidable and recoverable under SIPA section 78fff-2(c), sections 548(a) and 550(a)(1) of the Bankruptcy Code and could be preserved for the benefit of the estate under section 551 of the Bankruptcy Code. The Six Year Transfers were allegedly avoidable and recoverable under SIPA section 78fff-2(c) and sections 544(b), 550(a)(1) of the Bankruptcy Code, applicable provisions of N.Y. CPLR 203(g) and DCL sections 273 – 279 and could be preserved for the benefit of the estate under section 551 of the Bankruptcy Code.

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<sup>2</sup> Citations to “Adv. Pro. Dkt. No. \_\_\_” refer to the adversary proceeding against the Defendants, United States Bankruptcy Court for the Southern District of New York, Bankruptcy Docket No. 10-05172.

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3. The Defendants held a BLMIS account in the name of “Ascot Partners LP.” See Exhibit A to Amended Complaint. Ascot was among those determined by the Trustee to be “customers with claims for securities within the meaning of SIPA.” *In re Bernard L. Madoff Investment Securities LLC*, 654 F.3d 229, 233 (2d Cir. 2011).

4. On December 17, 2010, Ascot filed its Answer to the Amended Complaint (Adv. Pro. Dkt. No. 96). The Trustee and the Funds are currently engaged in discovery.

### Argument

5. Withdrawal of the reference of a proceeding that meets the terms of the second sentence of 28 U.S.C. § 157(d) is mandatory:

The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

6. For the reasons set forth in the Schwartz Motion, and because the issues raised in the Schwartz Motion are equally applicable to Ascot, the Receiver submits that the reference should be withdrawn as to the following issues:

(a) Whether the debt of BLMIS to its customer under non-bankruptcy securities laws constitutes antecedent debt to the customer, such that payment to the customer discharges antecedent debt and provides a customer who took that payment in good faith with a complete defense to a claim that the payment was a fraudulent transfer (the “Antecedent Debt Issue”).<sup>3</sup>

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<sup>3</sup> The Court granted partial summary judgment to the Trustee in *Katz*, ruling that transfers made to customers in excess of their investment were not on account of an antecedent debt constituting value for the purposes of Section 548(c). Order dated March 5, 2012 (*Katz* Dkt. No.142). However, as a result of the settlement in *Katz* on March 19, 2012, that Order did not become a final order subject to appellate review. The Defendants reserve their rights to raise this issue pending further order of the Court in this or another case.

(b) Whether payments to customers by BLMIS, a registered stockbroker and a debtor in a SIPA proceeding open only to registered brokers, are within the statutory “safe-harbor” of Section 546(e) of the Bankruptcy Code that protects from avoidance (except under section 548(a)(1) of the Bankruptcy Code) “settlement payments” made by a stockbroker “in connection with a securities contract” (the “546(e) Issue”).

(c) Whether SIPA and other securities laws alter the standard the Trustee must meet in order to show that a defendant did not receive transfers in “good faith” under section 548(c), and, if so, whether the applicable duty of inquiry of a stockbroker’s customer requires that the Trustee show that a defendant was “willfully blind” in order to establish a lack of good faith (the “Good Faith Issue”).

(d) Whether, after the United States Supreme Court’s decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011), final resolution of claims to avoid transfers as fraudulent requires an exercise of “judicial Power” reserved for Article III courts, preventing the bankruptcy court from finally resolving such claims, and, if the bankruptcy court cannot finally resolve the fraudulent transfer claims, it has the authority to render findings of fact and conclusions of law before final resolution (the “Stern v. Marshall Issue”).

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**Conclusion**

For the reasons set forth above and in the Schwartz Motion, the Receiver respectfully requests that the District Court: (a) order mandatory withdrawal of the reference of this case to resolve the Antecedent Debt Issue, the 546(e) Issue, the Good Faith Issue and the Stern v. Marshall Issue, each of which requires substantial and material consideration and interpretation of federal non-bankruptcy law; and (b) grant the Defendants such other and further relief as may be just or necessary.

Dated: New York, New York  
April 2, 2012

Respectfully submitted,

/s/ Daniel M. Glosband

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**CERTIFICATE OF SERVICE**

I, hereby certify that on April 2, 2012, I caused a true and correct copy of the forgoing to be served by electronic means, via the Court's CM/ECF system, on all counsel registered to receive electronic notices. I also certify that I have caused copies of the aforementioned document to be served via first class mail, postage prepaid upon the non-CM/ECF participants indicated in the Notice of Electronic Filing.

/s/ Daniel M. Glosband  
Daniel M. Glosband