11-5044-bk

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

In Re: BERNARD L. MADOFF INVESTMENT SECURITIES LLC.,

IRVING H. PICARD,

Plaintiff-Appellant,

—against—

(*caption continued on inside cover*)

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

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

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JPMorgan Chase & Co., JPMorgan Chase Bank, N.A.,
J.P. Morgan Securities LLC, J.P. Morgan Securities Ltd.,

Defendants-Appellees,

—and—

Securities Investor Protection Corporation,

Intervenor.

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STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

This matter was brought in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") by Irving H. Picard, as trustee (the "Trustee") pursuant to the Securities Investor Protection Act, 15 U.S.C. § 78aaa *et seq*. ("SIPA"), for the liquidation of the business of Bernard L. Madoff Investment Securities LLC ("BLMIS"), substantively consolidated with the estate of Bernard L. Madoff ("Madoff").

The Bankruptcy Court had subject matter jurisdiction pursuant to 28 U.S.C. § 1334(b) as well as 15 U.S.C. §§ 78eee(b)(2)(A) and (b)(4). On May 23, 2011, the United States District Court for the Southern District of New York (the "District Court") withdrew the Bankruptcy Court reference pursuant to 28 U.S.C. § 157(d). (*See* A-639-54) On November 1, 2011, the District Court entered an order dismissing the Trustee's common law causes of action and the claim for contribution. *See Picard v. JPMorgan Chase & Co.*, 460 B.R. 84 (S.D.N.Y. 2011); (SPA-1-33[1]) The District Court ruled that there was no just reason to delay an appeal and certified the aforementioned order as final pursuant to Fed. R. Civ. P. 54(b) on November 30, 2011 (the "Rule 54(b) Judgment"). (A-1577-79; *see also*

[1] For convenience, references to *Picard v. JPMorgan Chase & Co.*, 460 B.R. 84 (S.D.N.Y. 2011) will cite the Special Appendix and will omit citations to the Bankruptcy Reporter.

SPA-34) The District Court entered the Rule 54(b) Judgment on December 1, 2011. (SPA-34)

Appellate jurisdiction over the Rule 54(b) Judgment is conferred on this Court by 28 U.S.C. § 1291. On December 1, 2011, the Trustee timely filed a Notice of Appeal, invoking this Court's appellate jurisdiction pursuant to 28 U.S.C. §§ 158(d) and 1291. (A-1580-82)

STATEMENT OF ISSUES PRESENTED

I. Whether the District Court erred in holding that the Second Circuit's holdings in *Redington v. Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978) ("*Redington I*"), *rev'd on other grounds*, 442 U.S. 560 (1979), concerning: (a) a SIPA trustee's standing as a bailee; and (b) the Securities Investor Protection Corporation's ("SIPC") standing as a subrogee of customer claims, are no longer good law.

II. Whether the Second Circuit's holding in *St. Paul Fire & Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688 (2d Cir. 1989) allows the Trustee to assert claims to redress generalized injury suffered by BLMIS customers and/or creditors.

III. Whether the District Court erred in holding that, independent of *Redington I*, the Trustee lacks standing to assert common law causes of action against third parties on behalf of the customer property estate.

IV. Whether the District Court erred in holding that the affirmative defense of *in pari delicto*, as adopted and modified by the Second Circuit in *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991) ("*Wagoner*"), bars the Trustee from asserting common law causes of action.

V. Whether the District Court erred in holding that the Trustee does not have the right to enforce SIPC's subrogation rights and to pursue causes of action against third parties.

VI. Whether the District Court erred in ruling that the Trustee lacks standing and cannot assert a claim for contribution under New York law.

STATEMENT OF THE CASE

In the aftermath of Madoff's decades-long Ponzi scheme, the Trustee was appointed pursuant to SIPA to liquidate the business of BLMIS, and recover and distribute customer property to BLMIS customers.

In perpetrating the Ponzi scheme, Madoff did not act alone. As is now well known, a cadre of financial institutions, including the JPMorgan Defendants (collectively "JPMC" or "Defendants"),[2] participated in Madoff's scheme, despite knowledge of the fraud. JPMC was among the most instrumental in perpetuating Madoff's scheme, to the detriment of BLMIS's customers and creditors.

JPMC was at the very center of the Ponzi scheme. As Madoff's primary bank for over two decades, it provided the infrastructure for Madoff's deception. Madoff's primary checking account at JPMC—the "703 Account"—showed no signs of securities trading; despite billions of dollars in monthly transactions, no money was ever transferred to a securities counterparty. All of the transactions were between the customers and BLMIS. Yet, instead of blowing the whistle, JPMC quietly profited from the fraudulent scheme, increasing both its entanglement with Madoff and its potential profits by structuring financial products tied to his strategy. Years of superficial, yet damaging due diligence

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[2] The Defendants include JPMorgan Chase & Co., JPMorgan Chase Bank, N.A., J.P. Morgan Securities LLC and J.P. Morgan Securities Ltd., all of which are Appellees here.

conducted by JPMC employees was intentionally ignored. And when the collapse of Madoff's scheme became imminent, JPMC silently liquidated its position, leaving its clients and BLMIS's customers holding the bag.

Drawing on Second Circuit precedent and SIPA, the Trustee asserted traditional avoidance claims under both federal and state law against the Defendants, as well as seven common law claims seeking damages and other relief. (A-752-800, at ¶¶ 326-589) The common law claims alleged aiding and abetting fraud, aiding and abetting breach of fiduciary duty, knowing participation in a breach of trust, conversion, aiding and abetting conversion, fraud on the regulator, and unjust enrichment (collectively, the "common law claims"). (A-775-99, at ¶¶ 490-583) The Trustee also asserted a claim for contribution under New York law. (A-799-800, at ¶¶ 584-89)

Confronted with the Trustee's allegations and demand for damages, JPMC moved to withdraw the reference of the action from the Bankruptcy Court. (A-18-20) The District Court granted the motion. Thereafter, JPMC moved to dismiss the Trustee's common law claims and the contribution claim.[3] (A-930-31) In an Opinion and Order dated November 1, 2011 (the "November 1 Order"), the

[3] JPMC also moved to dismiss certain bankruptcy law claims relating to a $145 million loan from JPMC to BLMIS. (A-930) The District Court did not address this aspect of the motion to dismiss, instead remanding this part of the motion to the Bankruptcy Court. (SPA-33)

Honorable Colleen McMahon, U.S.D.J., erroneously held that the Trustee lacks standing to assert common law claims against JPMC as bailee of customer property or as enforcer of SIPC's subrogation rights, and granted JPMC's motion to dismiss the state law claims.[4] (*See generally* SPA-1-33) The District Court also held that the Trustee lacks standing to assert the common law claims because of the affirmative defense of *in pari delicto* and the Second Circuit's holding in *Wagoner*. (SPA-6-8, 17-18) In addition, the District Court ruled that the Trustee could not assert a claim for contribution under New York law. (SPA-18-22)

On November 30, 2011, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, the District Court found that there was no just reason for delay and directed the Clerk of the Court to enter the Rule 54(b) Judgment, which was accomplished on December 1, 2011. (A-1577-79; *see also* SPA-34) The Trustee now appeals from the Rule 54(b) Judgment on the basis that the District Court erred in its November 1 Order holding that the Trustee lacks standing to assert the

[4] Unlike the district court in the parallel case of *Picard v. HSBC*, 454 B.R. 25, 36-37 (S.D.N.Y. 2011), the District Court here did not address whether the Trustee could bring common law claims based on assignments of claims from customers, finding that issue premature. (SPA-33) However, the District Court did hold that the Trustee could not pursue common law claims as a "hypothetical judgment creditor" under section 544(a) of the Bankruptcy Code. (SPA-11-17) The Trustee does not pursue this issue on appeal, but does appeal the District Court's errors with respect to its reading of *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972) and *St. Paul*, which reach beyond the hypothetical judgment creditor issue.

common law claims and lacks standing to assert or fails to state a claim for contribution. (A-1580-82) The Trustee submits that SIPA, the Bankruptcy Code, established precedent, New York law, and sound public policy grant him standing to assert the common law claims and the contribution claim.

STATEMENT OF FACTS

On December 11, 2008, federal agents arrested Madoff, revealing the existence of the largest Ponzi scheme in history. (A-680, at ¶ 53) On December 15, 2008, SIPC filed an application under SIPA § 78eee(a)(4)(B), alleging that because of its insolvency, BLMIS needed SIPA protection. (A-680, at ¶ 55) The Securities and Exchange Commission consented to the consolidation of its case with SIPC's action against Madoff. (A-680, at ¶ 55) The District Court appointed the Trustee under SIPA § 78eee(b)(3) and referred the case to the Bankruptcy Court pursuant to SIPA § 78eee(b)(4). (A-680-81, at ¶¶ 56(a)-(d))

A. The Trustee Was Appointed to Recover Customer Property.

Upon his appointment, the Trustee was vested with the powers enumerated by SIPA and the Bankruptcy Code, including the powers to investigate the circumstances of BLMIS's insolvency, to recover funds to maximize the customer property estate, and to equitably distribute those funds to victimized customers. (A-669-70, at ¶ 18; A-681-82, ¶ 60) Through his investigation, the Trustee has uncovered evidence of the significant roles of JPMC and the other defendants in the Ponzi scheme, all of whom caused damage to the customer property estate that the Trustee is obligated to maximize. (*See, e.g.*, A-662-63, at ¶ 1) SIPC has advanced, to date, approximately $800 million to the Trustee in order to satisfy

customer claims.[5] The Trustee seeks in this action to hold JPMC liable for its conduct.

B. JPMC Prolonged and Expanded the Ponzi Scheme.

The JPMC-Madoff relationship requires neither a complex analysis nor a great deal of imagination. JPMC was Madoff's primary bank for 20 years. (A-633, at ¶ 2) On a daily basis, JPMC saw the nuts and bolts of Madoff's scheme: the money customers deposited into BLMIS's main account was not used to buy or sell securities, but was instead merely transferred to other customers in patterns that could serve no legitimate business purpose. (A-633, at ¶ 3) Every single dollar of stolen money went in and out of JPMC. Hundreds of billions of dollars of customer moneys were commingled and washed for nearly two decades through what is now known as Madoff's "703 Account"—a simple checking account at JPMC. (A-633, at ¶ 2)

Turning a blind eye to the myriad of blatant irregularities, in 2006, JPMC extended its relationship with Madoff into structured products, which revealed a host of other red flags. (A-665-66, at ¶ 6) And even after bank employees openly

[5] *See* Seventh Application of Trustee and Baker & Hostetler LLP for Allowance of Interim Compensation for Services Rendered and Reimbursement of Actual and Necessary Expenses Incurred from February 1, 2011 Through May 31, 2011, at 14. *SIPC v. Bernard L. Madoff Inv. Sec. LLC (In re BLMIS)*, No. 08-01789 (Bankr. S.D.N.Y. Sept. 21, 2011) (ECF No. 4376). Information on SIPC's advance is publicly available at http://www.madofftrustee.com/distributions-16.html.

speculated that Madoff was running a Ponzi scheme, JPMC proceeded with offering Madoff-related securities to investors. (A-695-97, at ¶¶ 119-25) By virtue of its relationship with Madoff, JPMC reaped rewards in the hundreds of millions of dollars, leaving the customers to suffer the devastating consequences. (A-716, at ¶ 198)

C. The Luncheon and the Google Search.

On June 15, 2007—almost eighteen months before Madoff's confession—John Hogan, the Chief Risk Officer at JPMC, had lunch with Matt Zames, who headed the Interest Rate Trading, Global Foreign Exchange, Public Finance, Global Mortgages, Tax-Oriented Investments, and Global Fixed Income groups at JPMC's Investment Bank. Zames warned Hogan about Madoff over lunch. (A-694, at ¶ 72; A-685, at ¶ 76; A-695, at ¶ 119) Summing up what the world now knows, Hogan immediately shared what he learned from Zames with his colleagues: "For whatever it[']s worth, I am sitting at lunch with Matt Zames who just told me that there is a well-known cloud over the head of Madoff and that his returns are speculated to be part of a [P]onzi scheme." (A-695, at ¶ 119)

Hogan's warning included a reminder about the lesson that should have been learned from the Refco fraud, about which there "was noise . . . for years before it was discovered to be rotten to the core." (A-696, at ¶ 120) In response, JPMC decided to have "one of the juniors" run a "Google" search to determine whether

Madoff was running a Ponzi scheme. (A-696, at ¶ 121) When this "junior" presented a single article concerning a proposed change in SEC regulations—which had nothing to do with Madoff at all—JPMC decided to conduct no further objective research. (A-696, at ¶¶ 121-22) As the Amended Complaint shows, this was not an isolated incident.

D. 22 Years of Silence While Collecting Fees.

The Hogan-Zames luncheon was hardly the first look JPMC had into Madoff's fraud. To the contrary, the JPMC-Madoff relationship spans more than 20 years, reaching back to when Madoff first opened a checking account—now known as the 703 Account—at Chemical Bank in 1986. (A-716, at ¶ 199) This was the primary account for Madoff's Investment Advisory ("IA") business. (A-663, at ¶ 2) Yet, because Madoff was running a Ponzi scheme, the 703 Account had none of the hallmarks of a normal broker-dealer account. Customer funds came in, but those funds were never segregated or transferred to separate sub-accounts. (A-715, at ¶ 192)

JPMC knew that Madoff claimed to be running an investment advisory business, with thousands of customers and $20 billion under management. The 703 Account was a single retail checking account—not even a special commercial account. (A-728-29, at ¶¶ 237-38) The transactions in the 703 Account never reflected the outflows and inflows necessary to show that securities were bought

and sold. (A-715, at ¶ 192) Between 1998 and 2008, Madoff transferred nearly $84 billion out of the 703 Account to just four customers; this represented over 75% of all the transfers from that account. (A-732, at ¶ 249) Incredibly, in all the years this money flowed in and out of JPMC like water, JPMC did not see a single check or a solitary wire to any securities clearing house, securities exchange, or to anyone who might be connected with the securities Madoff purported to purchase. (A-714, at ¶ 190) The account was essentially a bucket; money came in from one customer and stayed in until it was sent out to another customer. (A-663, at ¶ 3) It was a simple Ponzi scheme.

More troubling, the account displayed highly suspicious activity, including multi-million dollar check transactions, and inexplicable "roundtrip" patterns of multi-million dollar wire transfers between Madoff and certain of his customers. (A-715, at ¶ 193) The banking activities of one of Madoff's dearest friends and investors, Norman Levy (now deceased), were rife with signs of suspicious activity. JPMC was acutely aware of Levy's close relationship with Madoff, identifying Madoff as "Levy's close friend and trader," who had helped increase Levy's wealth from $180 million in 1986 to $1.5 billion in 1998. (A-734, at ¶ 255) Mr. Levy was also a highly important customer of JPMC—so important, that he maintained an office at the bank. (A-687, at ¶ 87)

Head-scratching volumes of cash deposits show that for the period from 1998 through Levy's 2005 passing, there were over $76 billion deposited into Levy's IA account with BLMIS. (A-731, at ¶ 247) In December 2001, shortly after two articles called into question Madoff's legitimacy, $6.8 billion was transferred back and forth between Madoff and Levy—exactly $3.4 billion deposited and $3.4 billion withdrawn. (A-734, at ¶¶ 252-53) This flow of funds all occurred through daily checks, each in the amount of $90 million. (A-734, at ¶ 254) During 2002, Madoff initiated outgoing transactions to Levy in the precise amount of $986,301—this occurred 318 separate times. (A-734, at ¶ 251) These highly unusual transactions often occurred multiple times on a single day. (A-734, at ¶ 251) And yet there was not as much as a whisper from JPMC.

This unusual activity should have prompted an investigation by the banker in charge of the account and should have triggered the bank's anti-money-laundering monitoring system. Long before the passage of the USA Patriot Act in 2001 ("Patriot Act"), and with greater force after Congress passed the Patriot Act, all banks, including JPMC, were required to fully understand the business in which their customers are engaged. (A-719, at ¶ 206) This responsibility—dubbed "Know Your Customer" or "KYC"—involved monitoring customers' transactions to detect and prevent money laundering and other suspicious activities. (A-719, at

¶ 206) The Patriot Act reinforced this obligation and underscored the importance of implementing robust detection systems. (A-715-16, at ¶ 196)

Yet for more than 20 years, JPMC allowed Madoff to move billions of dollars in deposits, redemptions, back-dated transactions, phony profit distributions, and other illegal payments in and out of this solitary checking account via wire transfers and checks—all without a scintilla of oversight, control, diligence, or common sense. JPMC did not question these practices. At the same time, JPMC was collecting an estimated half billion dollars in fees, interest payments, and revenue from the ability to use BLMIS customer funds on deposit. (A-714, at ¶ 190) Having been caught before for propping up the Enron fraud in order to profit and accommodate important customers, and having warranted to regulators that it had improved its oversight protection, JPMC knew better than to rely on a customer's public reputation in place of due diligence. (A-719, at ¶ 209)

E. A Piece of the Action.

The unusual account activity in the 703 Account should have been enough to steer JPMC away from Madoff. But it was not. By 2006, JPMC was no longer content being just Madoff's commercial banker. (A-688, at ¶ 91) Seeking a bigger piece of the Madoff pie, JPMC initiated an internal campaign across departments to become a major investor in Madoff by structuring derivative products directly tied to BLMIS feeder funds. (A-688, at ¶¶ 91-92) The transactions proposed

ranged from $5 million to $667 million, and were principally based on the returns of eight different BLMIS feeder funds and sub-feeder funds, including the Rye Funds, Thema, Herald, Fairfield Sentry, Fairfield Sigma, Lagoon, and Rafale Partners. (A-690, at ¶ 99; A-694, at ¶ 116)

As part of this process, JPMC began investigating these funds in 2006. JPMC's due diligence teams saw the problems from the start. Madoff purported to invest in S&P 100 equities and U.S. Treasury Bonds. (A-727, at ¶ 232) After a 2006 meeting with representatives from Fairfield Sentry and Fairfield Sigma, JPMC was puzzled by Madoff's returns: "from April to September 2002, the S&P 100 Index is down 30%, cash yielded 1%, and [Madoff] was able to generate over 6% returns." (A-688, at ¶ 92) Indeed, after Madoff's fraud came to light, Scott Palmer of JPMC's Equity Derivatives group, who personally investigated many of the feeder funds, acknowledged that Madoff's "[r]eturn seem[ed] a little too good to be true," and that Madoff's fraud "wasn't completely unexpected." (A-706, at ¶ 163; A-707, at ¶ 165) In the aftermath, JPMC conceded that it had "never been able to reverse engineer how [Madoff] made money" and Madoff "did not satisfy [JPMC's] requirement for administrative oversight." (A-708, at ¶ 171) Of course, JPMC made this concession while falsely stating that it did not invest with Madoff. (A-708, at ¶ 171)

In addition to the 703 Account activity, Madoff's refusal to provide pertinent account information should also have concerned JPMC. (A-691, at ¶ 105) Madoff resisted each of JPMC's attempts to perform due diligence, despite the fact that giving JPMC more comfort would have resulted in more money for him through additional investments. (A-691, at ¶ 105) Indeed, JPMC later admitted that Madoff's "Oz-like signals . . . were too difficult to ignore." (A-709, at ¶ 174)

But ignore them they did, and instead, JPMC turned to the Madoff feeder funds to "satisfy" JPMC's due diligence requirements. (A-691, at ¶ 106) The diligence it found from the feeder funds was horrifying. Echoing the description of Madoff as "Oz-like," JPMC noted that Madoff "seems to have fostered [a cult]" among his customers. (A-702, at ¶ 146) The individuals running the funds "seem[ed] very defensive and almost scared of Madoff. They seem[ed] unwilling to ask him any difficult questions and seem[ed] to be considering his 'interests' before those of the investors." (A-702, at ¶ 146) To sum up this lack of transparency, a JPMC employee concluded: "It doesn't look pretty." (A-689, at ¶ 95)

Actual meetings with the funds provided no comfort—instead, those meetings only breathed more life into the inescapable conclusion that Madoff was operating a fraud. Indeed, after a JPMC visit with Herald, a fund in which it placed more than $150 million, JPMC downgraded Herald's risk rating to the

lowest rating of "5-E." (A-698, at ¶¶ 131-32) Herald's operation caused JPMC to question whether assets actually existed at BLMIS. (A-698, at ¶ 132) At various points, JPMC noted that all of Madoff's "investors, sub-Custodians, auditors etc [sic] rely solely on Madoff produced statements and have no real way of verifying positions at Madoff itself." (A-693, at ¶ 111) JPMC concluded that "fraud presents a material risk"…"given the significant reliance on [Madoff] for verification of assets held, and no real way to confirm those valuations. . . ." (A-693, at ¶ 111) Yet, the JPMC-Madoff relationship continued.

F. The Withdrawal and the Collapse.

Much like every other Ponzi scheme, Madoff's scheme began collapsing when demands for redemptions exceeded cash on hand. (A-677, at ¶ 44) Put another way, the Madoff scheme began to collapse when the 703 Account became depleted. JPMC had direct insight into the troubling trend of the 703 Account.

In the weeks leading up to Madoff's collapse, JPMC redeemed over $276 million. (A-710, at ¶ 178) In a letter to the United Kingdom's Serious Organised Crime Agency ("SOCA"), JPMC's Vice President for the United Kingdom, wrote:

> Ultimately, [JPMC] reached the same conclusion it had reached during its initial due diligence efforts in 2006 and 2007; [JPMC] was unable to obtain lookthrough transparency at the Feeder Fund level, did not have access to the identities of the counterparties to Madoff's OTC options, did not fully understand the relationship between the broker-dealer and the investment advisor,

> and noted the fact that the custodians did not actually hold the assets.

(A-704, at ¶ 154) JPMC also sent a Suspicious Activity Report ("SAR") to SOCA stating:

> [JPMC]'s concerns around Madoff . . . are based (1) on the investment performance achieved by its funds which is so consistently and significantly ahead of its peers, year-on-year, even in the prevailing market conditions, as to appear too good to be true—meaning that it probably is; and (2) the lack of transparency around Madoff Securities' trading techniques, the implementation of its investment strategy, and the identity of its OTC option counterparties; and (3) its unwillingness to provide helpful information. As a result, [JPMC] has sent out redemption notices in respect of one fund, and is preparing similar notices for two more funds.

(A-704-05, at ¶ 155)

As these statements confirm, JPMC knew of these issues long before it began its redemptions, yet it kept quiet and did nothing, urging others to invest. When JPMC was explicitly warned in 2007 that BLMIS was a Ponzi scheme, it investigated by having one of its "juniors" run a Google search. (A-696, at ¶ 121) Eighteen months later, as the 703 Account vanished, JPMC redeemed, neatly extracting its own gems out of the mire.

G. The Victory Lap.

After Madoff's collapse, a member of JPMC's Equity Exotics division bragged:

> We've got a lot wrong this year but we got this one right at least—I said it looked too good to be true on that call with you in Sep. Despite suspecting it was dodgy I am still shocked to see this happen so suddenly. I guess it's true that when the tide goes out you see who is swimming naked.

(A-706, at ¶ 163) JPMC further stated matter-of-factly that it was "statistically impossible" for BLMIS to have generated 1.25% returns every month for years. (A-706, at ¶ 164) While noting that many of its clients lost money with Madoff, JPMC publicly congratulated itself stating "luckily we didn't place any there." (A-708, at ¶ 170) In the aftermath of Madoff's confession, JPMC vaunted its own expertise and analysis of the fraud as a way to lure new clients—looking for the next means to reap fees. (A-707-11, at ¶¶ 163-80)

The Trustee seeks to hold JPMC liable for its knowing participation in and perpetuation of Madoff's fraud, to the detriment of BLMIS customers and creditors.

SUMMARY OF THE ARGUMENT

The District Court erroneously dismissed the Trustee's common law claims concluding that: (1) *Redington v. Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978) ("*Redington I*"), *rev'd on other grounds*, 442 U.S. 560 (1979), lacked "any precedential value" and therefore was not binding; (2) *in pari delicto* and *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991) (*"Wagoner"*) prevented the Trustee from asserting the common law claims; (3) SIPC does not have a right of equitable subrogation; and (4) the Trustee could not assert a claim for contribution under New York state law. (SPA-6-7, 14-15, 18-22, 25-29)

First, *Redington I*'s holding that a SIPA trustee is a real party in interest has been recognized as binding precedent by the Supreme Court and the Second Circuit. *See Holmes v. SIPC*, 503 U.S. 258, 271 n.17 (1992); *SIPC v. BDO Seidman, LLP*, 222 F.3d 63, 69 (2d Cir. 2000) (Sotomayor, J.). *Redington I* held that a trustee, as the bailee of the customer property fund, and SIPC, as the subrogee of customer claims, have standing to pursue common law and equitable claims against third parties. These holdings have never been vacated or reversed, and remain the law of this Circuit. And with good reason. As this Court has long recognized, consistent with its decision in *Redington I*, a trustee has exclusive standing to bring claims that are generalized as to customers or creditors; such is

the case here. *See St. Paul Fire and Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688 (2d Cir. 1989) (*"St. Paul"*).

Second, *in pari delicto* and *Wagoner* should not be applicable to a SIPA trustee who recovers and marshals customer property, and then equitably distributes it to customers. In a typical bankruptcy where the shareholders of the debtor could be in a position to benefit from the recovery, *in pari delicto* and *Wagoner* impute to the bankruptcy trustee the wrongdoing of the debtor—the intent being to keep the wrongdoers from reaping any benefit from a recovery action. But this is not a typical bankruptcy. A SIPA trustee's role is different from that of a typical bankruptcy trustee. A SIPA trustee marshals assets for the benefit of the customer property estate. Neither the debtor nor its shareholders (nor any wrongdoer) can benefit from any recovery for the customer property estate. As such, the policy concerns behind the application of the equitable doctrine of *in pari delicto* and *Wagoner*—that no wrongdoer should recover—do not exist here. Indeed, because the Trustee is the only party who has standing to assert claims generalized to customers or creditors, applying *in pari delicto* here would impede, not promote, equity.

Third, SIPA grants SIPC equitable and statutory rights of subrogation to recover sums equal to the amounts advanced to customers. 15 U.S.C. § 78fff-3(a). By enacting SIPA, Congress did not intend to preclude or abolish claims for

equitable subrogation. Nor did it intend for its allocation scheme to preclude the Trustee's claim for equitable or statutory subrogation. SIPC has advanced approximately $800 million to satisfy the claims of BLMIS's customers and is therefore entitled to recover from those legally responsible for the damage.

Fourth, the Trustee has the authority to assert a claim for contribution against JPMC as joint tortfeasors. The Trustee alleges that JPMC engaged in, for example, aiding and abetting fraud, aiding and abetting breach of fiduciary duty, and aiding and abetting conversion. These claims arise under New York law, not SIPA, and thus the claim for contribution for joint liability arises under New York law. Therefore, New York law applies, not federal law. Thus, the District Court erred in dismissing the Trustee's sufficiently pleaded claim for contribution.

Accordingly, the District Court's dismissal of the Trustee's common law claims and contribution claim should be reversed.

STANDARD OF REVIEW

All of the issues presented here were decided by the District Court in connection with a motion to dismiss for lack of standing and/or failure to state a claim for relief pursuant to Fed. R. Civ. P. 12(b)(1) and 12(b)(6). The Second Circuit reviews *de novo* a district court's dismissal of causes of action for failure to state a claim for relief or lack of standing. *Schulz v. U.S. Fed. Reserve Sys.*, 370 F. App'x 201, 202 (2d Cir. 2010); *Fulton v. Goord*, 591 F.3d 37, 41 (2d Cir. 2009).

ARGUMENT

The District Court's November 1 Order incorrectly applies *Wagoner*, confuses concepts of statutory standing and real party in interest, and rejects the binding precedent of this Circuit. It further ignores the substantive relationship between the Trustee, SIPC and the customer property that the Trustee seeks to recover for the benefit of BLMIS customers. The Trustee has standing and is the real party in interest to assert the common law claims on behalf of the customer property estate. *Redington I* is good law; *St. Paul* must be followed; *Wagoner* is inapplicable; SIPC has a right to equitable and statutory subrogation; and the Trustee has the right to, and has sufficiently pleaded a claim for contribution under New York law. Accordingly, the District Court's November 1 Order must be reversed in its entirety.

I. *Redington I*'s Holdings on Real Party in Interest Are Good Law.

The Trustee is the real party in interest to assert claims on behalf of the customer property estate and to redress generalized injuries to customer property. In *Redington I*, the Second Circuit held that a SIPA trustee is the bailee of customer property:

> To the extent that customers have claims that have not been satisfied . . . , [customers] retain rights of action against [third parties]. We hold that the Trustee, as bailee, is an appropriate real party in interest to maintain this action on their behalf.

592 F.2d at 625. Any recovery through claims the Trustee asserts as bailee would repair the customer property estate, and any recovery would be allocated to victimized BLMIS customers.

Redington I did not create the law of bailment. Outside of *Redington I*, a bailee's status to sue as a real party in interest is well-established. *See* Fed. R. Civ. P. 17(a). *Redington I* is a judicial recognition of the special relationship between a SIPA trustee and the fund of customer property. The Trustee's possessory interest in customer property embodies that relationship and allows the Trustee to assert claims to redress injury to that property.[6] *See, e.g.*, 15 U.S.C. § 78fff-2(c)(3).

Moreover, the District Court relies on *Picard v. HSBC Bank PLC, et al.*, 454 B.R. 25 (S.D.N.Y. 2011) (hereinafter, the "HSBC Court"), which erroneously held that *Redington I*'s reversal by the Supreme Court on other grounds meant that the Second Circuit lacked subject matter jurisdiction and, therefore, that all of its holdings were invalid. (SPA-26-29) Neither the Supreme Court, nor the Second Circuit, has vacated or reversed *Redington I*'s holdings that a trustee has standing to sue as a bailee of customer property and that SIPC has standing to sue as a subrogee of customer claims. (SPA-25-26) The cases relied upon by the District

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[6] The District Court further erroneously reasoned that a bailment could not exist either because Madoff was a thief or because the bailment occurred prior to the Trustee's interest in the fund of customer property. (SPA 30-31) However, these distinctions are irrelevant in a SIPA context, *inter alia*, given that the Trustee is the real party in interest charged with recouping customer property.

Court, *e.g., National R.R. Passenger Corp. v. Nat'l Ass'n of R.R. Passengers*, 414 U.S. 453 (1974) (hereinafter, *"National Railroad"*), do not alter these conclusions. (SPA 27-28)

A. A SIPA Trustee Has Standing to Sue as a Bailee of Customer Property, and SIPC Has Standing to Sue as a Subrogee of Customers' Claims.

The Trustee is an appropriate real party in interest here. He has standing, as the bailee, to assert common law claims on behalf of the customer property estate. SIPC is also a real party in interest and can assert claims against third parties as the equitable subrogee of customers to whom it made advances for their loss of customer property.[7] The authority for both of these propositions is grounded in the precedential holdings of *Redington I*.

In *Redington I*, a SIPA trustee asserted claims against the accountant of the debtor, alleging that the accountant violated section 17(a) of the Securities & Exchange Act of 1934 (the "Exchange Act") by issuing misleading statements about the debtor's financial condition. *See Redington I*, 592 F.2d at 619-20. The Second Circuit held: (1) a private cause of action exists under section 17(a) of the Exchange Act; (2) a SIPA trustee, as a bailee of customer property, has standing as a real party in interest to assert state law claims to redress damage to customer

[7] The Trustee is authorized to enforce SIPC's subrogation rights by an assignment of these rights from SIPC.

property; and (3) SIPC can sue as the equitable subrogee of customers to whom it made advances to cover their losses of customer property. *See id.* at 623-25. Each of these holdings was independent of the other.[8] *See id.*

The Second Circuit first determined that a broker's customers have an implied right of action against third parties who violate section 17(a) of the Exchange Act. *See id.* at 623-24. It held that the section was intended to protect the broker's customers, which therefore implied a remedy in the form of a private cause of action for customers. *See id.* at 622-23.

As to a SIPA trustee's standing to assert common law causes of action, the *Redington I* Court recognized that a SIPA trustee has a right of possession in customer property and the duty to marshal and return that property under SIPA. *See id.* at 624-25. As a bailee, a SIPA trustee has the right to sue "any wrongdoer whom [the customers] could sue themselves." *Id.* at 625. Under the law of bailment, a bailee can vindicate harm to the bailed property based on his possessory interest. *See United States v. Perea*, 986 F.2d 633, 640 (2d Cir. 1993) ("[T]he bailee has a sufficient possessory interest to permit him to 'recover for the

[8] Unlike the HSBC Court, the District Court here assumed, without deciding, that *Redington I* can be read broadly to encompass standing for common law claims. (SPA-28) The District Court then erroneously construed the real party in interest holdings in *Redington I* to be "mere dict[a]" because of the Supreme Court's reversal on whether a private right of action existed under section 17(a) of the Exchange Act. (SPA-28-29) For the reasons discussed herein, the District Court's determination that *Redington I* is not good law is mistaken.

wrongful act of a third party resulting in the loss of, or injury to, the subject of the bailment.'") (quoting *Rogers v. Atl., Gulf & Pac. Co.*, 213 N.Y. 246, 258 (1915)).

As to SIPC's subrogation right, the Second Circuit disagreed with the notion that the statutory right of subrogation in SIPA is SIPC's exclusive remedy, and that SIPC would be precluded from asserting any actions against third parties. *Redington I*, 592 F.2d at 624; *see also* 15 U.S.C. § 78fff-3(a). The *Redington I* Court recognized that the existence of a statutory right of subrogation was not "meant to destroy SIPC's general common-law right of equitable subrogation." *Redington I*, 592 F.2d at 624.

> [W]e believe that it is more in keeping with the intent of Congress *that wrongdoers not receive a windfall benefit from the existence of SIPC*, and *that SIPC be able to recoup its losses from solvent wrongdoers*.

Id. (emphasis added).

On appeal, the Supreme Court considered only whether customers have an implied cause of action for damages under section 17(a) against accountants that are required to file reports under that section. *See Touche Ross & Co. v. Redington*, 442 U.S. 560, 562 (1979) (*"Redington II"*). Finding no implied cause of action, the Supreme Court dismissed the trustee's section 17(a) claim for failure to state a claim, and expressly determined that it was unnecessary for it "to reach [the] other rulings by the Court of Appeals." *Id.* at 567 n.9. The Supreme Court

declined to consider the Second Circuit's holdings that a SIPA trustee, as bailee of the customer property estate, and SIPC, as subrogee of customer claims, have standing to pursue state law and equitable claims against third parties. *See id.* Significantly, these holdings were neither vacated nor reversed, and remain the law of this Circuit.

The questions presented in *Redington I* were independent and unrelated to one another. A reversal on one issue did not necessitate the reversal, vacation or dismissal of the other holdings. The Supreme Court's reversal of a lower court decision on a question of substantive law is a merits determination that "leave[s] the decisions reached on other grounds intact." *Newdow v. Rio Linda Union Sch. Dist.*, 597 F.3d 1007, 1041 (9th Cir. 2010).

Only if a decision is vacated, rather than reversed on other grounds, will it automatically erase the precedential effect of the lower court's decision. *See Brown v. Kelly*, 609 F.3d 467, 476-77 (2d Cir. 2010) (citing cases regarding the difference between vacating and reversing); *see also Century Pines Land Co. v. United States*, 274 F.3d 881, 894 n.57 (5th Cir. 2001). The Supreme Court did not vacate the Second Circuit's real party in interest holdings in *Redington I*. *See Redington II*, 442 U.S. at 579. Only if the Supreme Court or the Court of Appeals *en banc* had "overruled, implicitly or expressly" its holdings on real party in interest would those holdings be vacated. Until then, the Second Circuit is bound

by *Redington I*. *See BDO Seidman*, 222 F.3d at 69 (quoting *Bank Boston, N.A. v. Sokolowski* (*In re Sokolowski*), 205 F.3d 532, 534-35 (2d Cir. 2000) (*per curiam*) ("This court is bound by a decision of a prior panel unless and until its rationale is overruled, implicitly or expressly, by the Supreme Court or this court *en banc*.")).

The District Court here rejected *Redington I*, reasoning that its "statements regarding bailee and subrogee standing are no longer good law." (SPA-29) The District Court accepted the HSBC Court's claim that all courts that relied on *Redington I* failed to understand that the Supreme Court's reversal was for "want of subject matter jurisdiction." (SPA-25) Both the HSBC Court's and the District Court's rulings misconstrue the scope of the Supreme Court's limited reversal on the merits and the impact of the Supreme Court's ruling in *Redington II*.

B. The Supreme Court's Merits-Based Reversal of *Redington I* Did Not Nullify the Second Circuit's Other Holdings.

The District Court's wholesale rejection of *Redington I*'s bailment and subrogation holdings goes far beyond the Supreme Court's decision in *Redington II*, which was limited to a merits-based reversal on the issue of whether a private right of action existed under section 17(a) of the Exchange Act. *See Redington II*, 442 U.S. at 567. The remainder of the Second Circuit's decision—that the trustee and SIPC were appropriate real parties in interest—was left untouched. *See Redington I*, 592 F.2d at 625.

Nonetheless, the District Court rejected *Redington I*, wrongly reasoning that dismissal for failure to state a claim resulted in a lack of subject matter jurisdiction. (SPA-25-29) The failure to state a claim, however, does not equate to a lack of subject matter jurisdiction:

> It is firmly established in our cases that the absence of a valid (as opposed to arguable) cause of action does not implicate subject-matter jurisdiction, *i.e.*, the courts' statutory or constitutional *power* to adjudicate the case.

Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 89 (1998) (citing 5A Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1350 (2d ed. 1990)); *see also Bell v. Hood*, 327 U.S. 678, 682 (1946) ("[J]urisdiction . . . is not defeated . . . by the possibility that the averments might fail to state a cause of action on which petitioners could actually recover.").

The *Redington I* Court had the requisite federal jurisdiction to make a merits-based inquiry into whether a private right of action existed under section 17(a) of the Exchange Act because that question involved interpreting the laws of the United States. *See Platzer v. Sloan-Kettering Inst. for Cancer Research*, 787 F. Supp. 360, 363 (S.D.N.Y. 1992), *aff'd*, 983 F.2d 1086 (Fed. Cir. 1992) (citing *Bell*, 327 U.S. at 682); *see also Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2877 (2010); *Steel Co.*, 523 U.S. at 89; *New York Stock Exch., Inc. v. Sloan*, No. 71 Civ. 2912, 1980 WL 1431, at *5 (S.D.N.Y. Aug. 15, 1980). When no private right

of action exists, a court will dismiss the case for failure to state a claim—not for want of subject matter jurisdiction. *See Morrison*, 130 S. Ct. at 2877;[9] *Chenkin v. 808 Columbus LLC*, 368 F. App'x 162, 163 (2d Cir. 2010), *cert. denied,* 131 S. Ct. 796 (2010); *Rodriguez ex rel. Rodriguez v. DeBuono*, 175 F.3d 227, 233 (2d Cir. 1999); *Platzer*, 787 F. Supp. at 363-64. Subject matter jurisdiction is not determined when a claim is dismissed on the ground that a statute does not support a private right of action; it remains an issue for the parties to later contest, if appropriate. *See Northwest Airlines, Inc. v. County of Kent, Mich.*, 510 U.S. 355, 365 (1994); *Rodriguez*, 175 F.3d at 233; *24 Hour Fuel Oil Corp. v. Long Island R.R. Co.*, 903 F. Supp. 393, 396 (E.D.N.Y. 1995).

The Supreme Court made no determination in *Redington II* that the lower court lacked subject matter jurisdiction. Nor did the Supreme Court in any way suggest that the Second Circuit did not have subject matter jurisdiction in *Redington I* to make its other rulings. Indeed, in *Redington II*, having determined

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[9] The HSBC Court rejected the application of *Morrison*, claiming that the issue in that case was "whether an accepted cause of action brought under § 10(b) was properly plead[ed], [and] not whether a private right of action existed at all." *HSBC Bank PLC*, 454 B.R. at 35 n.7. However, as Justice Scalia made clear, the Supreme Court granted *certiorari* in *Morrison* to decide if a particular provision of the "Securities Exchange Act of 1934 provide[d] a cause of action . . . ." *Morrison*, 130 S. Ct. at 2875. Similarly, *Redington I* and *Redington II* determined whether a private right of action existed under section 17(a), not whether that claim was properly pleaded. *See Redington I*, 592 F.2d at 621; *Redington II*, 442 U.S. at 562.

that section 17(a) of the Exchange Act did not imply a private right of action, the Supreme Court dismissed the claim for failure to state a claim for relief, and remanded the matter to the Second Circuit "for a decision on the Trustee's alternative bases for jurisdiction." *Redington v. Touche Ross & Co.*, 612 F.2d 68, 70 (2d Cir. 1979) ("*Redington III*"). On remand, the Second Circuit dismissed the state law claims because the court elected not to exercise pendent jurisdiction over the remaining state law claims against the accountant. *See id.* at 70, 72-73.

The Second Circuit's opinion in *Motorola Credit Corp. v. Uzan*, 388 F.3d 39 (2d Cir. 2004) further explains the distinction between a merits-based dismissal for failure to state a claim and a dismissal for lack of subject matter jurisdiction. The Second Circuit held, on the merits, that plaintiffs lacked statutory standing to assert a federal RICO claim—the single federal claim asserted. It dismissed the RICO claim for failure to state a claim. The Second Circuit did not find that the lower court lacked subject matter jurisdiction and, in fact, remanded the case to the district court to allow it to determine whether to retain jurisdiction. *See id.* at 55 ("[W]e dismissed Motorola's RICO claim on the merits rather than for lack of subject-matter jurisdiction."). On remand, the district court, in its discretion, exercised supplemental jurisdiction over the remaining state law claims. *See id.* at 47.

The *Motorola* and *Redington* cases demonstrate the District Court's error in relying upon *National Railroad* for the proposition that standing can never be determined separately from the question of whether a private right of action exists. (SPA-28) The District Court failed to recognize that the *National Railroad* Court's refusal to make a statutory standing determination was distinctly different from the Second Circuit's holdings on real party in interest in *Redington I*. *See National Railroad*, 414 U.S. at 456.

In *National Railroad*, the Supreme Court considered whether the National Association of Railroad Passengers ("NARP") could maintain a private cause of action under the Rail Passenger Service Act of 1980 (the "Amtrak Act"). The single federal claim asserted was the only claim presented; no additional state common law claims were involved. *See id.* If there were a private right of action under the Amtrak Act, the interrelated question was whether NARP would have had standing under the statute to assert the cause of action. *See id.* The Supreme Court held that there was no private right of action. *See id.* at 456, 464-65. As such, the Supreme Court determined that "questions of standing and jurisdiction bec[a]me immaterial," and did not rule on them.[10] *See id.* at 465 n.13.

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[10] In *Steel Co.*, the Supreme Court reiterated that *National Railroad* involved only the question of whether a statutory cause of action existed and did not address other standing concerns. 523 U.S. at 96-97.

Neither this case nor *Redington I* was limited to a single federal statute as in *National Railroad*. *Redington I* and this case involve common law determinations of whether a SIPA trustee is a real party in interest to assert state common law claims on behalf of the customer property estate—not whether a party has statutory standing.[11] Accordingly, a determination on the existence of a private right of action tied to a federal statute does not end the court's inquiry into a trustee's standing to assert state common law claims.

National Railroad can be further distinguished from the *Redington* cases. In *National Railroad*, whether the Amtrak Act created a private right of action and whether the respondent had standing to bring that action were virtually the same question, or at least were inextricably intertwined, as both required an analysis of

[11] The standing issue addressed in *National Railroad* was statutory standing, not standing to assert common law claims. Whether a statute creates a right of action and whether a party has standing under the statute are intertwined merits-based determinations that are separate and distinct from questions of constitutional standing and its prudential limitations. *See Graden v. Conexant Sys., Inc.*, 496 F.3d 291, 295 (3d Cir. 2007); *Steel Co.*, 523 U.S. at 97. Questions of standing and real party in interest require a court to determine the proper party to assert a claim to redress the alleged injuries. (SPA-6); *Energy Transp., Ltd. v. M.V. San Sebastian*, 348 F. Supp. 2d 186, 196 (S.D.N.Y. 2004) (noting that the doctrine of standing and the determination of a real party in interest are interrelated issues because both involve the issue of "who may initiate a claim"). As the District Court here recognized, referring to prudential limitations on standing, "a party must assert his own legal rights and interests." (SPA-6) But, as *Redington I*, *Redington II* and *Redington III* aptly demonstrate, the Trustee is a real party in interest, as the bailee of customer property, and SIPC is a real party in interest, as the subrogee for advances to customers. As such, they are authorized to assert claims against third parties to recover customer property.

the statute. 414 U.S. at 455-57. By contrast, in *Redington I*, the Second Circuit addressed the question of whether a SIPA trustee is a real party in interest as a bailee of customer property and whether SIPC is a subrogee, independent of whether section 17(a) of the Exchange Act created a private right of action. Whether the trustee and SIPC were real parties in interest who could assert the common law claims asserted in *Redington I* was not at all dependent on, or intertwined with, the interpretation of the Exchange Act. Therefore, unlike *National Railroad*, *Redington I*'s holdings on the common law claims were not inextricably intertwined with the finding that there was no private right of action under section 17(a) of the Exchange Act, and therefore remain binding precedent.

C. Decisions Since *Redington I* Reinforce its Precedential Value.

Redington I established the principle that a SIPA trustee has standing as a bailee and that SIPC has standing as a subrogee.[12] *See, e.g.*, *Appleton v. First Nat'l Bank of Ohio*, 62 F.3d 791, 800 n.7 (6th Cir. 1995); *Giddens v. D.H Blair & Co. (In re A.R. Baron & Co., Inc.)*, 280 B.R. 794, 805 (Bankr. S.D.N.Y. 2002); *SIPC v.*

[12] The District Court mistakenly looks to *Mishkin v. Peat, Marwick, Mitchell & Co.*, 744 F. Supp. 531 (S.D.N.Y. 1990) (*"Mishkin"*), to support its holding that *Redington* is no longer good law. (SPA-26) *Mishkin* addressed only the issue of subrogation (an express right of SIPC) and never reviewed or determined whether a trustee could sue as the bailee of customer property. *See generally Mishkin*, 744 F. Supp. at 556-58. Moreover, *Mishkin* did not address whether *Redington II* deprived *Redington I* of precedential value, but rather impermissibly overruled *Redington I*, leading other courts to find *Mishkin* to be an outlier opinion. *See Appleton v. First Nat'l Bank of Ohio*, 62 F.3d 791, 799-800 (6th Cir. 1995).

Cheshier & Fuller, L.L.P. (In re Sunpoint Sec., Inc.), 377 B.R. 513, 550 (Bankr. E.D. Tex. 2007), *aff'd sub. nom. Richardson v. Cheshier & Fuller, L.L.P.*, No. 6:07-CV-256, 2008 WL 5122122 (E.D. Tex. 2008).

Courts within the Second Circuit repeatedly have recognized *Redington I* as precedent. *See SIPC v. BDO Seidman, LLP*, 222 F.3d at 69; *SIPC v. BDO Seidman, LLP*, 49 F. Supp. 2d 644, 652 (S.D.N.Y. 1999), *aff'd in part*, 222 F.3d 63 (2d Cir. 2000); *Picard v. Taylor (In re Park S. Sec., LLC)*, 326 B.R. 505, 516 (Bankr. S.D.N.Y. 2005). The Supreme Court has implicitly acknowledged the precedential value of *Redington I*. *See Holmes,* 503 U.S. at 271 n.17.

Redington I's holdings identifying the real parties in interest are good law. Accordingly, the District Court's dismissal of the Trustee's common law claims was erroneous and should be reversed.

D. The District Court Redefined the Scope of *Redington I*.

The circumstances in *Redington I* that led to the Second Circuit's holding that the trustee was a real party in interest to assert common law claims for negligence, malpractice, breach of warranty and breach of contract are no different

from those at issue here.[13] There, as here, customers invested funds with a broker-dealer engaged in fraudulent activities, a third party took actions that perpetuated the fraud, the broker-dealer was put into liquidation, and a SIPA trustee was appointed. *Redington I*, 592 F.2d at 620. Based on these facts and a SIPA trustee's duties, the Second Circuit determined that the trustee was a real party in interest and could maintain an action against the third party for injuries that occurred prior to the liquidation. *Id.* at 625. Indeed, SIPA anticipates the fraudulent activities of broker-dealers, and thus defines "customer property" to include cash and securities "at any time received," and property "unlawfully converted." 15 U.S.C. § 78*lll*(4). Accordingly, the Trustee must consider the events and circumstances that led to the failure of BLMIS, and pursue actions to redress injuries to the fund of customer property.

II. A SIPA Trustee Has Exclusive Standing to Assert Common Law Causes of Action That Generally Affect All Customers.

Relying on *Caplin v. Midland Grace Trust Co.*, 406 U.S. 416 (1972), the District Court dismissed the Trustee's common law claims, holding that a trustee

[13] The District Court, as the HSBC Court, attempted to distinguish *Redington* and the law of bailment by, among other things, stating that because "SIPA's ratable distribution scheme" does not allow "customer property [to] be returned in substantially the same form in which it is given," a bailment cannot exist. (SPA-31); *HSBC Bank PLC*, 454 B.R. at 32. Obviously, SIPA's ratable distribution scheme was at play in *Redington* as well. Additionally, the District Court engaged in factual findings regarding the injury to customer property, using an analogy of a "parking garage," which is inapposite here. (SPA-30-31)

lacks standing to sue third parties on behalf of the bankrupt estate's creditors. (SPA-6-9, 12-13, 16) The District Court's holding is erroneous.

The Second Circuit's decision in *St. Paul* controls under the circumstances here. Under *St. Paul* and its progeny, a SIPA trustee has exclusive standing to assert claims to redress common injuries suffered by all customers—"generalized claims." *Id.* The *St. Paul* Court recognized that Congress intended that a trustee should be able to assert generalized creditor claims against the debtor, alter egos of the debtor, or "others who have misused the debtor's property in some fashion." *Id.* The *St. Paul* Court held that:

> If a claim is a general one, with no particularized injury arising from it, and if that claim could be brought by any creditor of the debtor, *the trustee is the proper person to assert the claim, and the creditors are bound by the outcome of the trustee's action.*

Id. (emphasis added). A claim is generalized when it can be brought by any creditor; it is particularized when it can *only* be brought by a specific creditor or a small group of creditors. *Koch Ref. v. Farmers Union Cent. Exch., Inc.*, 831 F.2d 1339, 1348-49 (7th Cir. 1987). The *St. Paul* Court reasoned that permitting a trustee to assert generalized creditor claims against third parties "would have the effect of bringing the property of the third party into the debtor's estate, and thus would benefit all creditors." 884 F.2d at 701.

The District Court erred in construing *St. Paul* to mean that the claims asserted by the Trustee must be "common" to BLMIS and its creditors in order for the Trustee to bring those claims. (SPA-14-15) While the issue in *St. Paul* was the bankruptcy trustee's standing to assert alter ego claims, the *St. Paul* Court's inquiry and holding were not confined to whether the debtor and creditors shared the same claim. Rather, the rationale for having the Trustee bring claims that were generalized as to all creditors was to avoid a race to the courthouse and inequitable recoveries:

> If the trustee is the only one with standing to bring a certain action, because of the generalized nature of the injury, it follows that those who are barred from bringing that same action in an independent proceeding should and will, under bankruptcy law, be bound by the outcome of the trustee's suit.

Id. at 700. The trustee's exclusive standing avoids the danger of inconsistent results through the lawsuits of individual creditors. *See id.* Therefore, the District Court's finding that granting the Trustee standing here would create a danger of duplicative recoveries is plainly wrong.[14] (SPA-7)

Moreover, *St. Paul*'s holding is especially relevant in the context of a Ponzi scheme where each creditor holds "other people's money." If only some creditors

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[14] Nor is the District Court correct in holding that allowing the Trustee to pursue generalized claims would deplete estate assets. (SPA-7) Assets of the customer property estate are never used to pay for the Trustee's lawsuits. The Trustee's litigation costs are paid by SIPC.

sued and recovered, others would be disadvantaged. The inevitable race to the courthouse would eviscerate the "net investment method" established by the Trustee and upheld by the Second Circuit. *See generally In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229 (2d Cir. 2011), *petition for cert. filed*, __ U.S.L.W. __ (Feb. 3, 2012) (Nos. 11-968, 11-969) ("*Net Equity Decision*").

St. Paul is not inconsistent with *Caplin*, the case cited by the District Court for the proposition that the Trustee lacks standing to bring claims on behalf of BLMIS customers. (SPA-6-9, 12-13, 16) *Caplin* stands for the straightforward proposition that a trustee representing the debtor's estate cannot assert *individualized* claims of certain creditors. *See* 406 U.S. at 434. It does not apply to a trustee asserting a generalized claim on behalf of all creditors. In *St. Paul*, the Second Circuit directly addressed *Caplin*, finding that *Caplin* does not control when a trustee is asserting a claim to redress a *generalized* injury. *See St. Paul*, 884 F.2d at 700; *see also Koch Ref.*, 831 F.2d at 1347 n.11 (*Caplin* "does not affect a trustee's right to bring a general action on behalf of all creditors rather than a personal one on behalf of only some.").

The District Court wrongly applied *Caplin*, misconstruing the facts of this case and holding that the claims here were individualized rather than generalized as to all creditors. The District Court based its ruling on the faulty reasoning that "recovery" will not necessarily accrue in the same way to all creditors. (SPA-15-

16) With no factual record before it to support its finding, the District Court stated that "[e]ven if the Trustee recovers all customer losses and provides excess to the general fund, a net winner may share in the recovery only ratably, while a net loser, a different class of creditor, recovers its claims against the estate in full." (SPA-16) The *amount* of recovery is irrelevant. In fact, recovery to creditors varies in any bankruptcy. *St. Paul* only requires that the *injury* be shared by all creditors. *See* 884 F.2d at 701. As all customers of BLMIS were *injured* by the malfeasance of JPMC, the standard set by *St. Paul* is met. *Caplin* therefore is inapplicable here.

St. Paul remains the precedent in this Circuit and should be followed. *See Kagan v. St. Vincents Catholic Med. Ctrs. (In re St. Vincents Catholic Med. Ctrs.)*, 449 B.R. 209, 217 (S.D.N.Y. 2011) (creditor's claim against third party violates the automatic stay because the trustee is the proper person to pursue claims for injuries that are generalized to all creditors); *Labarbera v. United Crane & Rigging Servs.*, Nos. 08-cv-3274, 08-cv-3983, 2011 WL 1303146, at *6 (E.D.N.Y. Mar. 2, 2011) (citing *St. Paul* and holding, "[w]here the harm suffered by the claimant is no different than the harm suffered by other creditors, the action belongs to the trustee or debtor-in-possession"); *Cohain v. Klimley*, Nos. 08 Civ. 5047, 09 Civ. 4527, 09 Civ. 10584, 2010 WL 3701362, at *10 (S.D.N.Y. Sept. 20, 2010) (relying on *St. Paul* and holding that avoidance actions and common law claims are the

"sole responsibility of the trustee" and "further[ ] the fundamental bankruptcy policy of equitable distribution among creditors"); *Green v. Bate Records, Inc. (In re 10th Ave. Record Distrib., Inc.)*, 97 B.R. 163, 165-66 (S.D.N.Y. 1989) (recognizing that the Second Circuit has concluded that bankruptcy trustees "have standing to assert . . . claims [that] benefit the entire estate in bankruptcy and are not particular to one creditor or group of creditors").

Here, the Trustee has asserted common law claims against JPMC. These are generalized claims because they would redress common injuries to BLMIS customers; injuries incurred as a result of JPMC's malfeasance. The Trustee's claims against JPMC are not claims that belong to a specific BLMIS customer or creditor. Indeed, neither JPMC nor the District Court identified any such customer or creditor. *St. Paul* therefore governs and provides the Trustee with exclusive standing to pursue the common law claims.

III. The District Court Erred in Applying *Wagoner* to Divest the Trustee of Standing to Assert Common Law Claims.

When the District Court below held that *Wagoner* and the doctrine of *in pari delicto* deprive the Trustee of standing to bring common law claims in federal court, it stripped the Trustee—and BLMIS customers—of the ability to hold JPMC and the other defendants liable for their complicity in the Ponzi scheme. (SPA-6-8, 17-18) The District Court concluded without any discussion of JPMC's conduct,

that Madoff's conduct should be imputed to the Trustee.[15] (SPA-17-18) The District Court further concluded that no exception to *in pari delicto* could exist and that the conduct of Madoff and BLMIS, neither of which stands to profit from the Trustee's action, barred the Trustee, from asserting common law claims. (SPA-17-18) The District Court's holdings, however, ignored the limitations of *Wagoner*'s application and the equitable considerations that drive both the doctrine of *in pari delicto* and SIPA. *See, e.g.*, *Peltz v. SHB Commodities, Inc.*, 115 F.3d 1082, 1090 (2d Cir. 1997); *Koch Indus., Inc. v. Hoechst Aktiengesellschaft*, 727 F. Supp. 2d 199, 212-13 (S.D.N.Y. 2010); *Kirschner v. KPMG, LLP*, 15 N.Y.3d 446, 474 (2010).

A. *Wagoner* Is Not Applicable to a SIPA Trustee.

Wagoner did not involve a SIPA trustee, but rather, a bankruptcy trustee who sought, on behalf of individual customers, a second bite at the apple for claims that were time-barred and had been previously disposed of in an arbitration. *See Wagoner*, 944 F.2d at 117-19. The claims barred in *Wagoner*, unlike the

[15] The District Court based this argument on the law of agency, finding that Madoff's wrongdoing as BLMIS's agent is imputed to BLMIS itself. (SPA-8) The District Court erred in reaching these findings, as it ignored the clear allegations in the Amended Complaint to the contrary. As pled, Madoff exerted "wrongful domination and control of BLMIS" and "[a]cted wholly outside the scope of his agency …, and entirely for his own and for third parties' personal benefit and purposes." (A-678-79, at ¶ 50) As the District Court itself admits, an agency relationship cannot exist when the agent acts outside his authority. (SPA-8)

Trustee's common law claims here, were the individualized claims of certain creditors. Those claims are unlike the Trustee's common law claims, which are generalized claims intended to redress damage to the customer property fund. These claims can only be asserted by a SIPA trustee. *See supra* Point II. *Wagoner* is therefore inapplicable here.

B. A SIPA Trustee Is Appointed to Restore the Customer Property Estate.

A SIPA trustee is the appropriate party in interest to assert common law claims on behalf of the customer property estate. This right is predicated on the distinct duties and the unique authority of a SIPA trustee. It is this authority and those duties that empower a SIPA trustee to assert common law claims on behalf of the customer property estate.

As the Second Circuit recognizes, the customer property estate and the general estate in a SIPA liquidation are separate estates with distinct characteristics and purposes. *Net Equity Decision*, 654 F.3d at 233; *Rosenman Family, LLC v. Picard*, 395 F. App'x 766, 768 (2d Cir. 2010). The customer property estate is comprised of recovered assets intended to satisfy customer claims.[16] 15 U.S.C.

[16] Before 1938, customers of a bankrupt stockbroker who could not trace their cash and securities to the debtor's possession were treated as general creditors. *See* Report of Special Study of Securities Markets of the Securities Exchange Commission ("1963 SEC Report"), H.R. Doc. No. 95, at 411 (1963). Thus, a customer's right to recover "depend[ed] largely upon the fortuitous circumstances

§78*lll*(4); *Rosenman*, 395 F. App'x at 768; *In re Adler Coleman Clearing Corp.*, 195 B.R. 266, 270 (Bankr. S.D.N.Y. 1996). By contrast, the general estate is intended to satisfy the claims of general unsecured creditors. The customer property estate cannot be used to satisfy general unsecured creditors' claims. *See Adler Coleman*, 195 B.R. at 270.

SIPA is chiefly concerned with the customer property estate. *See, e.g.*, *SEC v. First Sec. Co. of Chi.*, 507 F.2d 417, 420 (7th Cir. 1974) (SIPA was enacted "to protect, and secure equality of treatment for, 'the public customer . . . ."') (quoting *SEC v. F.O. Baroff Co., Inc.*, 497 F.2d 280, 283 (2d Cir. 1974)). Indeed, the primary purpose of a SIPA liquidation proceeding is to appoint a trustee to

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that stock of [one customer was] on hand, while that of another customer in the exact same relationship may not [have been] on hand." *Revision of the Bankruptcy Act: Hearings on H.R. 6439 and H.R. 8046 Before the H. Comm. on the Judiciary*, 75th Cong. 96 (1937). In response to this inequitable treatment of customers, Congress enacted section 60e of the Chandler Act.

Under that section, all customers—regardless of whether their property was specifically identifiable—would share *pro rata* in a single and separate fund. To the extent that the single and separate fund could not satisfy the claims of all customers, the trustee of a bankrupt stockbroker was charged with restoring the fund to what it should have been on the filing date and then ratably distributing the recovered fund assets to customers. *See* 1963 SEC Report, at 412. After a spate of stock brokerage insolvencies, Congress enacted SIPA to replace those provisions. *See* S. Rep. No. 91-1218, at 2-4 (1970); *see also* H.R. Rep. No. 91-1613, at 2-4, 10 (1970), *reprinted in* 1970 U.S.C.C.A.N. 5254, 5255-57; *SIPC v. Barbour*, 421 U.S. 412, 415 (1975).

maximize the customer property estate and to distribute such property to the customers of the debtor to the extent of their net equity claims. *See* 15 U.S.C. § 78fff(a)(1)(B); *SEC v. Albert & Maguire Sec. Co.*, 560 F.2d 569, 573-74 (3d Cir. 1977); *see also Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1986). In contrast, a bankruptcy trustee's duty "to administer a debtor's property, on behalf of the debtor's creditors, however, *only extends to estate property.*" *Old Trail Ltd., Inc. v. Graham (In re Weldon Stump & Co.)*, 383 B.R. 435, 438 (Bankr. N.D. Ohio 2008) (emphasis added).

C. *In Pari Delicto* Does Not Apply to a SIPA Trustee Who Proceeds on Behalf of the Customer Property Estate.

A SIPA trustee who seeks to recover assets for the benefit of a debtor's customers should not be impeded by the doctrine of *in pari delicto*. *See Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (*in pari delicto* should not interfere with enforcement of securities laws and protection of the investing public). *In pari delicto* allows a court faced with resolving a dispute between equally culpable wrongdoers to decline to intercede because the court should not lend its good offices to wrongdoers. *See Kirschner*, 15 N.Y.3d at 464. The policy behind *in pari delicto* is rooted in principles of equity, namely that courts should not permit a wrongdoer, fraudster or criminal to profit further from his wrongdoing by asserting claims for damages against other equally culpable

parties. *Id.* The equities disfavor applying *in pari delicto* when the doctrine would yield inequitable results. *Bateman Eichler*, 472 U.S. at 310.

Given the nature of the Trustee's appointment, the policy concerns underlying *in pari delicto* are absent here. The Trustee is, of course, not a wrongdoer himself. Further, the Trustee is the only party who can assert claims to redress damage to the customer property estate. *See supra* Point II. By imputing Madoff's wrongdoing to the Trustee, the District Court impeded the Trustee's duties and powers under SIPA and his right to assert common law claims to redress the harm JPMC inflicted upon the customer property fund. HSBC prolonged and expanded the Ponzi scheme, increasing the damage done to customers whose property was dissipated as the Ponzi scheme endured. The Trustee's ability to assert common law claims is critical to recovering funds for distribution to the victims of a decades-long Ponzi scheme.

"[T]he defense of *in pari delicto* [lost] its sting" when the Trustee was appointed under SIPA and Madoff was "ousted from control of and beneficial interest in" BLMIS. *See Scholes v. Lehmann*, 56 F.3d 750, 754-55 (7th Cir. 1995) (citing *McCandless v. Furlaud*, 296 U.S. 140, 160 (1935) (Cardozo, J.) (refusing to impute the bad acts of corporate promoters, shareholders and agents to the corporation)). The Trustee should not be tainted by Madoff's wrongdoing. *See, e.g.*, *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) (holding that the

misconduct of a failed bank should not be imputed to a receiver appointed to pursue state law claims and declining to apply *in pari delicto*); *McNamara v. PFS (In re The Personal and Business Ins. Agency)*, 334 F.3d 239, 245-47 (3d Cir. 2003) (holding that trustee was not tainted by debtor's fraud).

Further, no debtor, insider or any other wrongdoer will benefit from the Trustee's recovery of customer property. Congress has made clear that a person engaged in illegal or improper conduct is not given the protection that a customer would receive. "[A] customer [who] has acted improperly or illegally . . . may be denied SIPC protection." *SIPA Amendments: Hearings on H.R. 8064 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce*, 94th Cong. 169, 171-72 (1975) ("1975 SIPA Amendment Hearings").

Courts uniformly have held that SIPA is intended to safeguard only innocent investors. "One who engages in a fraudulent transaction cannot reap the benefits of the Act's intended protection." *SEC v. Packer, Wilbur & Co., Inc.*, 498 F.2d 978, 984 (2d Cir. 1974); *SEC v. N. Am. Planning Corp.*, No. 72 Civ. 3158, 1975 WL 346, at *2 (S.D.N.Y. Jan. 24, 1975); *Mishkin v. Siclari (In re Adler, Coleman Clearing Corp.)*, 277 B.R. 520, 558 (Bankr. S.D.N.Y. 2002).

SIPA's definition of customer also excludes the debtor's shareholders. 15 U.S.C. § 78*lll*(2)(B). To preserve the sanctity of the customer property estate,

Congress declined to permit "shareholders of the debtor and any persons who have subordinated their claims to those of other creditors" to have the protections of customers. *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the H. Comm. on the Judiciary*, 94th Cong. 2314 (1976). By excluding the debtor's shareholders and subordinated lenders, SIPA excludes those most readily positioned to engage in wrongdoing. *1975 SIPA Amendment Hearings*, at 182. Thus, the wrongdoers that *in pari delicto* is designed to bar from recovery will not benefit from distributions of customer property under SIPA, and the doctrine should not apply here.

D. The District Court Erred by Applying *In Pari Delicto* on the Pleadings.

The District Court erred in ruling, solely on the pleadings, that *in pari delicto* bars the Trustee from asserting common law claims. (SPA-8, 17-18) Courts should not apply *in pari delicto* before allowing an opportunity for pertinent discovery. *See, e.g.*, *Stanziale v. McGladrey & Pullen, LLP (In re Student Fin. Corp.)*, No. 02-11620, 2006 WL 2346373, at *2 (D. Del. Aug. 10, 2006); *OHC Liquidation Trust v. Credit Suisse First Boston (In re Oakwood Homes Corp.)*, 340 B.R. 510, 536 (Bankr. D. Del. 2006). Because the doctrine requires a court to assess factual questions, like the comparative fault of the wrongdoers, dismissal of a claim on the basis of *in pari delicto* is disfavored, absent discovery on that issue.

See, e.g., *Pinter v. Dahl*, 486 U.S. 622, 635 (1988); *Bateman Eichler*, 472 U.S. at 310-11; *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990). The doctrine should not be applied mechanically because it yields inequitable results. *See Bankruptcy Servs., Inc. v. Ernst & Young (In re CBI Holding Co., Inc.)*, 529 F.3d 432, 443 (2d Cir. 2008); *Krys v. Sugrue (In re Refco Sec. Litig.)*, 779 F. Supp. 2d 372, 375 (S.D.N.Y. 2011); *Official Comm. of Unsecured Creditors of Grumman Olson Indus., Inc. v. McConnell (In re Grumman Olson Indus., Inc.)*, 329 B.R. 411, 425 (Bankr. S.D.N.Y. 2005). Before imposing *in pari delicto*, courts are required to carefully examine the equities among the parties and whether exceptions to the doctrine should apply. *See, e.g.*, *Bateman Eichler*, 472 U.S. at 310; *Buckley v. Deloitte & Touche USA LLP*, No. 06 Civ. 3291, 2007 WL 1491403, at *1, *8 (S.D.N.Y. May 22, 2007); *Hirsch v. Tarricone* (*In re A. Tarricone),* 286 B.R. 256, 262 (Bankr. S.D.N.Y. 2002)*; Pan Am. Corp. v. Delta Air Lines, Inc.,* 175 B.R. 438, 499 (S.D.N.Y. 1994); *Bruno Machinery Corp. v. Troy Die Cutting Co., LLC (In re Bruno Machinery Corp.*), 435 B.R. 819, 833 (Bankr. N.D.N.Y. 2010).

Here, the District Court declined to address the complicated factual questions about JPMC's role in the Ponzi scheme. By dismissing on the pleadings, the District Court denied the Trustee the ability to demonstrate the comparative fault of the JPMC Defendants. *See McHale v. Citibank, N.A. (In re 1031 Tax Group, LLC)*, 420 B.R. 178, 194 (Bankr. S.D.N.Y. 2009) ("The problem is that

exceptions to the application of *in pari delicto* . . . can make it exceedingly difficult to resolve a case on a motion for lack of standing . . . [under] *Wagoner*."). When such "complex, fact-based issues abound, pre-answer dismissal should be an exception, not the rule." *Ross*, 904 F.2d at 824; *see also Kirschner*, 15 N.Y.3d at 478 (citing *Morgado Family Partners, LP v. Lipper*, 19 A.D.3d 262, 263 (1st Dept. 2005)).

By applying *in pari delicto* to bar the Trustee's standing, the District Court also, in error, placed the burden of pleading and proof upon the Trustee; had the Court applied *in pari delicto* under New York state law as an affirmative defense, JPMC would have had the burden of pleading and proof. *See Kirschner,* 15 N.Y.3d at 478 (citing *Woods v. Roundout Valley Cent. Sch. Dist. Bd. of Educ.*, 466 F.3d 232, 237 (2d Cir. 2006)). The consequences are significant. *See, e.g.*, *Schertz-Cibolo-Universal City Indep. School Dist. v. Wright (In re Educators Grp. Health Trust)*, 25 F.3d 1281, 1286 (5th Cir. 1994) ("That the defendant may have a valid [*in pari delicto*] defense on the merits of a claim . . . goes to the resolution of the claim . . . not to the ability of the debtor to assert the claim."). Given that this was a challenge to the Trustee's complaint, the Trustee's allegations should have been given the utmost deference and certainly should not have been dismissed solely on the pleadings.

The Trustee should not be burdened with the inequitable imposition of a doctrine intended to admonish wrongdoers. The Trustee is not a wrongdoer, fraudster or criminal. Nor will any parties complicit with the wrongdoer be able to benefit from the customer property estate. The purpose of *in pari delicto* is simply not present, and this Court should reject the notion that it should be applied in this case.

IV. SIPA Authorizes SIPC to Pursue Equitable and Statutory Subrogation Claims Against Third-Party Tortfeasors.

To expedite the payment of net equity claims to customers injured by an insolvent broker-dealer, SIPA requires SIPC to advance to the Trustee up to $500,000 for each customer. 15 U.S.C. § 78fff-3(a). The Trustee uses these advances to satisfy customer claims "for the amount by which the net equity of each customer exceeds his ratable share of customer property." *Id.* SIPC has advanced, to date, approximately $800 million to the Trustee under this provision. In exchange, SIPA grants SIPC equitable and statutory rights of subrogation to recover sums equal to the amounts advanced to customers. *Id.* In this case, SIPC has expressly assigned to the Trustee the right to enforce SIPC's rights of subrogation with respect to advances it has made, and is making, to customers of BLMIS from SIPC funds. (A-670, at ¶ 20(h))

A. The District Court Erred in Holding That SIPC's Subrogation Rights Were Limited and That the Trustee, as Assignee of SIPC's Rights, Does Not Have Standing to Enforce Those Rights.

SIPA § 78fff-3(a) provides that:

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

15 U.S.C. § 78fff-3(a) (emphasis added). Rather than give meaning to the plain language of the statute, the District Court limited SIPC's statutory and equitable rights of subrogation. The District Court first erroneously found that SIPC is only subrogated "to the extent of customer *net equity claims against the customer*, and not against any other party."[17] (SPA-31 (emphasis added)) The District Court also erroneously determined that any implied right of subrogation against third parties would "undermine the SIPA distribution scheme," because "SIPC can recover only after the customers have recovered their net equity claims." (SPA-32-33) Lastly, the District Court erroneously relied on the HSBC Court's conclusion that although SIPA § 78fff-3(a) grants SIPC "all other rights it may have in law or in equity,"

[17] The District Court misstates the language of the statute as cited above. The net equity claims are against the customer property estate, not the customer.

SIPC does not have a right of equitable subrogation because this right would also contradict the allocation scheme set forth in SIPA § 78fff-2(c)(1) by permitting SIPC to recover before customers' net equity claims had been paid in full. (SPA-32) The District Court's wholesale rejection of SIPC's right to assert equitable and statutory subrogation claims in the proceeding below was legal error.

1. SIPC Has a Right of Equitable Subrogation That Allows it to Assert Common Law Claims Against Third Parties.

The District Court erred in holding that SIPC lacks standing under principles of equitable subrogation. In exchange for making advances to BLMIS customers under SIPA § 78fff-3(a), SIPC has the right to pursue both its express right of subrogation and "all other rights it may have at law or in equity." 15 U.S.C. § 78fff-3(a). These "other rights" include the right to pursue claims against third parties as an equitable subrogee.

Equitable subrogation recognizes that a person who pays for another's loss steps into that person's shoes, and has the opportunity to recover from whoever is liable for that loss. *See Fasso v. Doerr,* 12 N.Y.3d 80, 86 (2009); *Rink v. State*, 901 N.Y.S.2d 480, 482 (N.Y. Ct. Cl. 2010), *aff'd*, 929 N.Y.S.2d 903 (4th Dept. 2011). Equitable subrogation is created by the "equities of the situation," *Aetna Cas. & Sur. Co. v. Norwalk Foods, Inc.*, 480 N.Y.S.2d 851, 852 (N.Y. Civ. Ct. 1984), and is used to "promote justice and prevent unjust enrichment." *Hamlet at*

Willow Creek Dev. Co., LLC v. Ne. Land Dev. Corp., 878 N.Y.S.2d 97, 112 (2d Dept. 2009); *Tishman Realty & Constr. Co v. Schmitt*, 330 N.Y.S.2d 174, 177-78 (N.Y. Civ. Ct. 1972). Courts favor the application of equitable subrogation and have extended, rather than restricted, its application. *See 3105 Grand Corp. v. N.Y.C.*, 288 N.Y. 178, 182 (1942); *Brown v. Bellamy*, 566 N.Y.S.2d 703, 704 (3d Dept. 1991). The doctrine broadly encompasses:

> every instance in which one party pays a debt for which another is primarily answerable and which in equity and good conscience should have been discharged by the latter, so long as the payment was made either under compulsion or for the protection of some interest of the party making the payment, and in discharge of an existing liability.

Hamlet, 878 N.Y.S.2d at 112.

The subrogee acquires all of the subrogor's rights, defenses and remedies, and can proceed directly against third parties to recoup the amount paid. *See Peerless Ins. Co. v. Michael Beshara, Inc.*, 903 N.Y.S.2d 833, 835 (3d Dept. 2010); *see also Allstate Ins. Co. v. Mazzola*, 175 F.3d 255, 258 (2d Cir. 1999). Once the subrogee has paid the subrogor, he need not delay proceeding with his claims. *See, e.g.*, *Winkelmann v. Excelsior Ins. Co.*, 85 N.Y.2d 577, 584 (1995); *Fasso*, 12 N.Y.3d at 87.

This is consistent with the equitable nature of the right of subrogation. As the Second Circuit previously observed, "it is more in keeping with the intent of

Congress that wrongdoers not receive a windfall benefit from the existence of SIPC, and that SIPC be able to recoup its losses from solvent wrongdoers." *Redington I*, 592 F.2d at 624. Equitable subrogation is based on the related concept that the party who causes injury or damage should bear the loss. *See Fasso*, 12 N.Y.3d at 87. Acknowledging SIPC's right to pursue equitable subrogation claims is logically and equitably compelling:

> While a liquidation under [SIPA] is similar to a bankruptcy liquidation, there is a key difference: a bankruptcy trustee has no trust fund to distribute to make creditors whole. Thus, bankruptcy law does not speak to the need, desirability, or authority for repaying that fund through subrogation actions such as the one at issue.

Appleton, 62 F.3d at 800 (declining to accept "*Mishkin*'s rejection of *Redington*'s analogy to insurance law based on [SIPA's] roots in bankruptcy law").

SIPC has advanced approximately $800 million to satisfy claims of BLMIS customers, and is therefore entitled to recover from those legally responsible for the damage. All elements necessary for equitable subrogation are present, and the authorization for SIPC to assert such a claim is recognized in SIPA § 78fff-3(a). Thus, upon advancing funds to pay customers' net equity claims, SIPC acquired all rights, defenses and remedies of the customers, and has standing to proceed directly against the third parties that caused their injuries, including JPMC. *See Peerless Ins. Co.*, 903 N.Y.S.2d at 835; *Mazzola*, 175 F.3d at 258.

In denying SIPC's subrogation right, the District Court misconstrued the allocation scheme in SIPA as limiting SIPC's subrogation rights. As discussed above, SIPA § 78fff-2(c)(1) simply dictates the order by which funds are allocated from the estate of customer property. It provides that funds must first be allocated to a customer before SIPC, as subrogee, can receive any recovery from the estate. It does *not* limit or restrict when SIPC can assert a claim for relief against third-party tortfeasors; nor does it limit the claims for relief available to SIPC. A subrogation claim, like a contribution claim or an indemnity claim, may be asserted at any time during the pendency of the underlying action even though the subrogee may only later recover damages. *See Seguros Banvenez, S.A. v. S/S Oliver Drescher*, 761 F.2d 855, 861 (2d Cir. 1985) (insurer, as subrogee, and its insured could maintain joint action against wrongdoer to recover full amount of loss); *Lumbermans Mut. Cas. Co. v. 606 Rest., Inc.*, 819 N.Y.S.2d 511, 514-15 (1st Dept. 2006) (insurer that failed to intervene in underlying action was collaterally estopped from litigating its subrogation claim); *Omiatek v. Marine Midland Bank*, 781 N.Y.S.2d 389, 389 (4th Dept. 2004) (insurer permitted to intervene to assert equitable subrogation claim in underlying action); *Rink*, 901 N.Y.S.2d at 484 (insurer permitted to intervene in underlying action).

2. SIPA Does Not Preclude SIPC's Standing to Assert Subrogation Claims Against Third-Party Tortfeasors.

The District Court also erred in finding that SIPC can only assert its statutory subrogation claim only against the customer property estate. (SPA-31) First, nowhere does SIPA § 78fff-3(a) limit SIPC's standing as a subrogee to assert claims *against third parties*. Rather, the statutory language is clear and should be construed as written: "SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this chapter. . . ." 15 U.S.C. § 78fff-3(a). The District Court again misconstrued the statutory language—"except that SIPC as subrogee may assert no claim against customer property until after the allocation thereof to customers as provided in section 78fff-2(c) of this title"—as limiting SIPC's right to assert subrogation claims only against the customer property estate, and not against third parties. (SPA-31)

The existence of a statutory allocation scheme in SIPA, however, does not give courts authority "to impose other limitations that are inconsistent with the text and the statute's purpose and design." *Bilski v. Kappos*, 130 S. Ct. 3218, 3226 (2010); *see also C.I.R. v. Clark*, 489 U.S. 726, 739 (1989) (the exception should be construed narrowly to preserve the primary operation of the general provision); *Estate of Pew v. Cardarelli*, 527 F.3d 25, 31 (2d Cir. 2008) (holding that applying an exception in a statute to all claims would render the exception's terms of

limitation meaningless). Here, SIPA § 78fff-3(a) merely limits *when* SIPC can *recover* against the customer property estate and requires only that SIPC await payment of its subrogation rights until the customers' claims have been allocated. *See McKenny v. McGraw (In re Bell & Beckwith)*, 937 F.2d 1104, 1108-09 (6th Cir. 1991). It does not restrict SIPC's rights to bring subrogation claims against third parties.

3. The District Court's Interpretation and Application of *Redington I* to Subrogation Was Erroneous as a Matter of Law.

For the same reasons set forth in Point I, *supra*, the Second Circuit's holding in *Redington I* with respect to SIPC's right of equitable subrogation remains binding precedent in this Circuit. Thus, SIPC's right of equitable subrogation remains good law.

V. The Court Erroneously Dismissed the Trustee's State Law Claim for Contribution Against the Defendants.

The District Court perfunctorily determined that the Trustee cannot assert a state law claim for contribution because: (1) SIPA does not expressly provide for a claim of contribution; and (2) the Trustee is not subject to "liability for damages," as required by the New York contribution statute. (SPA-20-21) Neither of these conclusions is grounded in law and the District Court's decision must be reversed.

A. The Trustee's Claim for Contribution Is Grounded in New York Law.

The Trustee's claim for contribution does not arise out of SIPA, nor is it predicated on violations of SIPA. Rather, the Trustee's claim for contribution is grounded in New York law. In the Amended Complaint, the Trustee alleges, for example, aiding and abetting fraud, aiding and abetting breach of fiduciary duty, and aiding and abetting conversion. Specifically, the Trustee contends that JPMC and the other defendants funneled assets to BLMIS, expanded the Ponzi scheme, and deepened BLMIS's insolvency, all of which caused and augmented the injury suffered by the victims of BLMIS's fraudulent activities. (A-799-800, at ¶¶ 584-87) These torts arise under New York law. Logically, the claim for contribution against JPMC for joint liability arises under New York law as well.

The right of contribution under New York law is an independent claim that arises whenever "two or more persons . . . are subject to liability for damages for the same . . . injury to property . . . ." N.Y. C.P.L.R. 1401 (McKinney 2011). It is this joint liability under New York law that is the core of a right of action for contribution. *See* N.Y. C.P.L.R. 1401; *N.Y. State Elec. & Gas Corp. v. FirstEnergy Corp.*, No. 3:03 Civ. 0438, 2007 WL 1434901, at *8 (N.D.N.Y. May 11, 2007) ("[T]he lynchpin of New York's contribution provision is common liability for the same injury.").

In fact, a claim for contribution is available "whether or not the culpable parties are allegedly liable for the injury under the same or different theories" and "'may be invoked against concurrent, successive, independent, alternative and even intentional tortfeasors.'" *Calcutti v. SBU, Inc.*, 273 F. Supp. 2d 488, 493 (S.D.N.Y. 2003) (citing *Steed Finance LDC v. Laser Advisers, Inc.*, 258 F. Supp. 2d 272, 283 (S.D.N.Y. 2003) (quoting *Raquet v. Braun*, 90 N.Y.2d 177, 182 (1997))). The Trustee has a valid contribution claim against JPMC and other defendants, as joint tortfeasors, based upon the theory that JPMC and these defendants acted in concert with Madoff in the Ponzi scheme.

B. A SIPA Trustee Has the Authority to Assert a Claim for Contribution.

The District Court erred in dismissing the Trustee's contribution claim by determining that the Trustee's rights are relegated solely to the specific rights granted by SIPA. (SPA-20-22) The District Court's analysis is wrong.

The Trustee has broad authority under SIPA to bring claims. SIPA § 78fff(b) expressly incorporates portions of title 11 of the Bankruptcy Code. Section 541(a)(1) of the Bankruptcy Code makes clear that the "estate is comprised of all of the following property, wherever located and by whomever held [including] all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1); *see also* 15 U.S.C. § 78fff-

1(b); 11 U.S.C. § 323. "[C]hoses in action" and claims the debtor has against others as of the commencement of the case are part of the debtor's property. H.R. No. 95-595, at 367-68 (1977); S. Rep. No. 95-989, at 82-83 (1978); *Air Line Pilots Ass'n, Int'l v. Am. Nat'l Bank & Trust Co. of Chi. (In re Ionosphere Clubs, Inc.)*, 156 B.R. 414, 436-37 (S.D.N.Y. 1993), *aff'd*, 17 F.3d 600 (2d Cir. 1994) ("A debtor's interests in property, including causes of action, are defined by state law, and become assets of the estate once the bankruptcy petition is filed.").

In recovering the property of the estate, the Trustee has the right to assert causes of action. 15 U.S.C. § 78fff-1(b); 11 U.S.C. § 323; *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.9 (1983); *Allard v. Arthur Andersen & Co.*, 924 F.Supp. 488, 495-96 (S.D.N.Y. 1996). These causes of action include a claim for contribution under state law. *See, e.g.*, *Kittay v. Atl. Bank of New York (In re Global Serv. Group LLC)*, 316 B.R. 451, 464 n.13 (Bankr. S.D.N.Y. 2004) (a trustee may assert a contribution claim against defendants jointly liable for the same injuries suffered by a third party); *Westerhoff v. Slind (In re Westerhoff)*, 688 F.2d 62, 64 (8th Cir. 1982) (chapter 11 debtor can assert contribution claim against co-obligor based on installment payments made on joint obligation); *A.P.I., Inc. v. Home Ins. Co.*, 706 F. Supp. 2d 926, 947 (D. Minn. 2010) (estate of bankrupt asbestos manufacturer can assert contribution claims against successor-in-interest to liquidated insurer); *Seitter v. Schoenfeld*, 88 B.R. 343, 350 (D. Kan. 1988)

(trustee may assert contribution claim against accountants that reviewed debtor's financial statements); *Kotoshirodo v. Hancock and Kapaa 382 LLC (In re Lull)*, No. 07-90072, 2009 WL 2225450, at *5 (Bankr. D. Haw. July 23, 2009) (trustee of bankruptcy estate of deceased fraudster may assert contribution claim against co-owner of debtor's company and the company itself); *Hill v. Day (In re Today's Destiny, Inc.)*, 388 B.R. 737, 750 (Bankr. S.D. Tex. 2008) (trustee's claim for contribution not subject to *in pari delicto*); *Friedman v. Morabito (In re Morabito)*, No. 94-2542, 1995 WL 502909, at *3 (4th Cir. 1995) (contribution is a core bankruptcy proceeding and can represent a major asset of a bankrupt estate); *SIPC v. Cheshier & Fuller, LLP* (*In re Sunpoint Sec., Inc.*), 377 B.R. 513, 570 (Bankr. E.D. Tex. 2007) (any recovery on state law claims by SIPA trustee, as successor-in-interest to failed brokerage, is reduced by five percent (brokerage's percentage of fault) under Texas's proportionate responsibility statute).

C. New York Law Provides the "Rules of Decision" for State Law Causes of Action.

The District Court's dismissal of the contribution claim is a result of its erroneous conclusion that federal law provides the "rules of decision" for the claim because the Trustee's payment obligations arise out of SIPA. (SPA-20-21) This is incorrect. The Trustee's right to assert a contribution claim under New York law is based on the breach of state law duties, for example, the claims of aiding and

abetting fraud, and aiding and abetting breach of fiduciary duty. (A-755-75, at ¶¶352-489; A-779-87, at ¶¶ 507-35) These causes of action arise under New York law, which therefore, provides the rules of decision.

No court has held that a SIPA trustee's claims must be rooted in federal law simply because he was appointed under SIPA or because he has SIPA-imposed payment obligations. Cases that involve federal statutes providing a claim for relief are inapposite here; those cases hold only that federal law would supply the "rules of decision" to determine whether a contribution claim was intended by the federal statute at issue in the case. (SPA-20-21) Here, the Trustee does not seek contribution for violations of SIPA or any other federal statute. *See KBL Corp. v. Arnouts*, 646 F. Supp. 2d 335, 341 (S.D.N.Y. 2009) (plaintiff cannot use New York law to seek contribution under the Copyright Act, which does not permit contribution); *LNC Invs., Inc. v. First Fidelity Bank, Nat'l Ass'n*, 935 F. Supp. 1333, 1349 (S.D.N.Y. 1996) ("It follows that there can be no right of contribution under New York law based on an alleged breach of the [federal statute]."); *Northwest Airlines, Inc. v. Transp. Workers Union of Am., AFL-CIO*, 451 U.S. 77, 97 (1981) (the liability that is the basis for the contribution claim is "entirely a creature of federal statute"); *Lehman Bros., Inc. v. Wu*, 294 F. Supp. 2d 504, 504-05 n.1 (S.D.N.Y. 2003) (contribution in connection with a federal statutory scheme is governed solely by federal law). The contribution claim is based on state law.

See Northwest Airlines, 451 U.S. at 97 & n.38. New York law—not federal law—supplies the "rules of decision."

Nor does the statutory allocation scheme for payment in a SIPA liquidation preclude the Trustee from seeking a claim for contribution. SIPA authorizes the Trustee to bring suits generally, including state law causes of action. *See supra* Points I and II. The common law claims and the claim for contribution are governed neither by SIPA nor the Bankruptcy Code but, rather, by state law. The Supreme Court makes this point clear in *Northwest Airlines*:

> Of course, federal courts, including this Court, have recognized a right to contribution under state law in cases in which state law supplied the appropriate rule of decision.

451 U.S. at 97 n.38.

Judge Michael B. Mukasey's opinion in *LNC Investments* makes this distinction plain. Although it denied the defendant's motion to seek contribution from a third party based on the Trust Indenture Act, a federal statute with no provision permitting contribution, the court *granted* defendant's motion to seek contribution (under N.Y. C.P.L.R. 1401) based on an alleged breach of fiduciary duty. 935 F. Supp. at 1348. Thus, although "there can be no right of contribution under New York law based on an alleged breach of [a federal statute]," a claim for

contribution may lie "on the basis of plaintiffs' state law claim of breach of fiduciary duty." *Id* at 1349.

In *In re Today's Destiny*, the court allowed a bankruptcy trustee's contribution claim in a similar context. 388 B.R. at 751. Purchasers of equipment whom the debtor had defrauded filed proofs of claim. *See id.* at 750. The bankruptcy trustee sued the lenders who financed the equipment sales and leases for aiding and abetting the fraud, and sought contribution from the lenders for the debtor's liability. *See id.* at 750-51. The district court held that the trustee had stated a valid claim for contribution under state law even though the debtor's liability had not yet been determined. *See id.* at 754-55.

D. The Trustee Has Sufficiently Pleaded a Claim for Contribution Under New York Law.

The Trustee may seek contribution from JPMC as a joint tortfeasor under New York law. N.Y. C.P.L.R. 1401, 1403 (McKinney 2011). The Trustee will pay proportionately thousands of allowed customer claims seeking to recover billions of dollars invested with BLMIS and diverted by Madoff. JPMC is liable for a commensurate portion of those claims as joint tortfeasors. This action, in

part, seeks a determination of JPMC's joint liability for the injury to customer property.[18]

1. A Customer Claim Constitutes an "Adverse Judgment."

The District Court determined that "the Trustee's obligation to pay arises not from the common law of New York, but from SIPA [and the Trustee] is not 'subject to liability for damages' for the 'same injury to property' caused by Defendants." (SPA-18); *see also HSBC*, 454 B.R. at 37-38. The District Court's reasoning here was unclear. As set forth above, joint liability under New York law is the lynchpin to a right of action for contribution. *See* N.Y. C.P.L.R. 1401. The Trustee has already alleged JPMC's complicity—conduct that resulted in injury to customer property. New York law requires only the existence of either an adverse judgment or other compulsion to pay. *See, e.g.*, *FirstEnergy*, 2007 WL 1434901, at *7 (N.D.N.Y. May 11, 2007). Each of the thousands of customer claims filed in the liquidation proceeding compels the Trustee to pay. Courts have held that an order establishing liability satisfies this adverse judgment requirement. *See, e.g.*, *In re Today's Destiny*, 388 B.R. at 754-55 (in a proceeding to resolve a contested proof of claim, a trustee need not show another compulsion to pay in order to

[18] New York law allows the Trustee to assert the claim for contribution in the underlying action. *See Klinger v. Dudley*, 41 N.Y.2d 362, 369 (1977) ("[A] main defendant may assert his claim for contribution prior to the payment of any amount to the plaintiff.").

assert a contribution claim); *FirstEnergy*, 2007 WL 1434901, at *7 (finding that agency orders "can represent the satisfaction of a tort-like liability. . . ."). Further, where, as here, many customer claims have been paid by the Trustee with moneys advanced by SIPC, the compulsion requirement is satisfied. *See Relyea v. State*, 399 N.Y.S.2d 710, 711 (3d Dept. 1977) (right of contribution accrues on the date upon which payment is made by the party seeking contribution).

2. The Trustee Sufficiently Alleges a Claim for Contribution.

The Trustee has alleged sufficient facts that, if accepted as true, "state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). "When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief." *Id.* at 1950.

The Trustee's allegations about JPMC are sufficient to state a claim for relief. The Trustee alleges that JPMC committed intentional torts. JPMC supplied billions of dollars to perpetuate the Ponzi scheme, greatly increasing the damage done, and the customer claims that the Trustee must satisfy on behalf of BLMIS. This more than adequately sets forth a claim for contribution. *See, e.g.*, *Contino v. Lucille Roberts Health Spa*, 509 N.Y.S.2d 369, 370 (2d Dept. 1986); *Raquet*, 90 N.Y.2d at 183; *FirstEnergy*, 2007 WL 1434901, at *5. On a motion to dismiss, it

is enough that the Trustee has adequately alleged that JPMC has tort liability. *See LNC Inv.,* 935 F. Supp. at 1349.

It was therefore error for the District Court to dismiss the Trustee's claim.

CONCLUSION

For the foregoing reasons, the Trustee respectfully requests that this Court reverse in its entirety the District Court's Rule 54(b) Judgment, embodying the November 1 Order, and remand the matter for further proceedings.

Date: New York, New York
February 16, 2012

Respectfully submitted,

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11-5175-bk

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

In Re: BERNARD L. MADOFF INVESTMENT SECURITIES LLC,

Debtor.

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

Plaintiff-Appellant,

(*caption continued on inside cover*)

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

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

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—against—

HSBC BANK PLC, HSBC SECURITIES SERVICES (LUXEMBOURG) S.A., HSBC BANK BERMUDA LIMITED, HSBC FUND SERVICES (LUXEMBOURG) S.A., HSBC PRIVATE BANK (SUISSE) S.A., HSBC PRIVATE BANKING HOLDINGS (SUISSE) S.A., HSBC BANK (CAYMAN) LIMITED, HSBC SECURITIES SERVICES (BERMUDA) LIMITED, HSBC BANK USA, N.A., HSBC INSTITUTIONAL TRUST SERVICES (BERMUDA) LIMITED, HSBC SECURITIES SERVICES (IRELAND) LIMITED, HSBC INSTITUTIONAL TRUST SERVICES (IRELAND) LIMITED, HSBC HOLDINGS PLC, UNICREDIT S.P.A., PIONEER ALTERNATIVE INVESTMENT MANAGEMENT LIMITED, UNICREDIT BANK AUSTRIA AG, ALPHA PRIME FUND LIMITED,

Defendants-Appellees,

—and—

SECURITIES INVESTOR PROTECTION CORPORATION,

Intervenor.

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STATEMENT OF SUBJECT MATTER
AND APPELLATE JURISDICTION

This matter was brought in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") by Irving H. Picard, as trustee (the "Trustee") pursuant to the Securities Investor Protection Action, 15 U.S.C. § 78aaa *et seq.* ("SIPA"), for the liquidation of the business of Bernard L. Madoff Investment Securities LLC ("BLMIS"), substantively consolidated with the estate of Bernard L. Madoff ("Madoff").

The Bankruptcy Court had subject matter jurisdiction pursuant to 28 U.S.C. § 1334(b) as well as 15 U.S.C. §§ 78eee(b)(2)(A) and (b)(4). On April 25, 2011, the United States District Court for the Southern District of New York (the "District Court") withdrew the Bankruptcy Court reference pursuant to 28 U.S.C. § 157(d). On July 28, 2011, the District Court entered an order pursuant to Fed. R. Civ. P. 12(b)(1) and 12(b)(6) dismissing the Trustee's common law causes of action and the claim for contribution (the "July 28 Order"). On August 8, 2011, the District Court entered an order modifying the order entered on July 28 to also dismiss the Trustee's common law causes of action and claim for contribution as to UniCredit Bank Austria AG. The District Court ruled that there was no just reason to delay an appeal and certified the aforementioned orders as final pursuant to Fed. R. Civ. P. 54(b) on December 8, 2011. The District Court entered the Rule 54(b) judgment on December 12, 2011 (the "Rule 54(b) Judgment").

Appellate jurisdiction over the Rule 54(b) Judgment is conferred on this Court by 28 U.S.C. § 1291. On December 13, 2011, the Trustee timely filed a Notice of Appeal, invoking this Court's appellate jurisdiction pursuant to 28 U.S.C. §§ 158(d) and 1291.

STATEMENT OF ISSUES PRESENTED

I. Whether the District Court erred in holding that the Second Circuit's holdings in *Redington v. Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978) ("*Redington I*"), *rev'd on other grounds*, 442 U.S. 560 (1979), concerning: (a) a SIPA trustee's standing as a bailee; and (b) the Securities Investor Protection Corporation's ("SIPC") standing as a subrogee of customer claims, are no longer good law.

II. Whether the Second Circuit's holding in *St. Paul Fire & Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688 (2d Cir. 1989) allows the Trustee to assert claims to redress generalized injury suffered by BLMIS customers and/or creditors.

III. Whether the District Court erred in holding that, independent of *Redington I*, the Trustee lacks standing to assert common law causes of action against third parties on behalf of the customer property estate.

IV. Whether the District Court erred in holding that the affirmative defense of *in pari delicto*, as adopted and modified by the Second Circuit in *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991) ("*Wagoner*"), bars the Trustee from asserting common law causes of action.

V. Whether the District Court erred in holding that the Trustee does not have the right to enforce SIPC's subrogation rights and to pursue causes of action against third parties.

VI. Whether the District Court erred in ruling that the Trustee cannot assert a claim for contribution under New York law.

STATEMENT OF THE CASE

In the aftermath of Madoff's decades-long Ponzi scheme, the Trustee was appointed pursuant to SIPA to liquidate the business of BLMIS, and recover and distribute customer property to BLMIS customers.

In perpetrating the Ponzi scheme, Madoff did not act alone. As is now well known, a cadre of financial institutions, funds created for the sole purpose of investing in BLMIS (*i.e.* feeder funds), and individuals—including the other defendants herein—participated in Madoff's scheme despite knowledge of the fraud. UniCredit S.p.A. ("UniCredit"), Pioneer Alternative Investment Management Limited ("Pioneer") and UniCredit Bank Austria AG ("Bank Austria") (collectively, the "UniCredit entities") were among the most instrumental in perpetuating Madoff's scheme, to the detriment of BLMIS's customers and creditors.

The UniCredit entities were part of a European network of interrelated hedge funds, investment advisers, management companies, and service providers. Bank Austria, Sonja Kohn—one of Madoff's chief ambassadors—and 20:20 Medici AG ("Bank Medici") set up several feeder funds that invested more than $2.8 billion of capital into BLMIS. As managers and investment advisers, the UniCredit entities had first-hand knowledge of the impossibility of Madoff's purported trading

activity. These entities consciously disregarded numerous account and investment irregularities, collecting millions from their association with Madoff.

Drawing on Second Circuit precedent and SIPA, the Trustee asserted traditional avoidance claims under both federal and state law against all defendants, as well as four common law causes of action, alleging aiding and abetting fraud, aiding and abetting breach of fiduciary duty, unjust enrichment, and money had and received (collectively, the "common law claims"). The Trustee also asserted a claim for contribution under New York law.

Confronted with the Trustee's allegations and demand for damages, the UniCredit entities moved to withdraw the reference of the action from the Bankruptcy Court. The District Court granted the motion, withdrawing the reference for the limited purpose of addressing two threshold issues: (1) whether the Trustee has standing to assert the common law claims against, *inter alia*, the UniCredit entities, and (2) whether these claims are preempted by the Securities Litigation Uniform Standards Act.

Fifteen of the forty defendants—including the UniCredit, Pioneer and HSBC—moved to dismiss the common law claims and the contribution claim. In his July 28 Order, the Honorable Jed S. Rakoff, U.S.D.J., erroneously held that the Trustee lacks standing to "bring his common law claims either on behalf of customers directly or as bailee of customer property, enforcer of SIPC's

subrogation rights, or assignee of customer claims" and granted the motion to dismiss the state law claims filed by UniCredit and Pioneer. *Picard v. HSBC Bank PLC*, 454 B.R. 25, 36 (S.D.N.Y. 2011); (SPA-22).[1] On August 8, 2011, the District entered an order to dismiss the Trustee's common law claims and contribution claim as to Bank Austria. The District Court also held that the Trustee lacks standing to assert the common law claims because of the affirmative defense of *in pari delicto* and the Second Circuit's holding in *Wagoner*. (SPA-22-24) In addition, the District Court ruled that the Trustee could not assert a claim for contribution under New York law. (SPA-24-25)

On December 8, 2011, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, the District Court found that there was no just reason for delay and directed the Clerk of Court to enter the Rule 54(b) Judgment, which was done on December 12, 2011. The Trustee now appeals from the Rule 54(b) Judgment on the basis that the District Court erred in its July 28 Order by holding that the Trustee lacks standing to assert the common law claims and the contribution claim. The Trustee submits that SIPA, the Bankruptcy Code, established precedent, New York law, and sound public policy grant him standing to assert the common law claims and the contribution claim.

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[1] For convenience, references to *Picard v. HSBC Bank PLC*, 454 B.R. 25 (S.D.N.Y. 2011) will cite to the Special Appendix and will omit citations to the Bankruptcy Reporter.

STATEMENT OF FACTS[2]

On December 11, 2008, federal agents arrested Madoff, revealing the existence of the largest Ponzi scheme in history. (A-42, at ¶ 28) On December 15, 2008, SIPC filed an application under SIPA § 78eee(a)(4)(B), alleging that because of its insolvency, BLMIS needed SIPA protection. (A-42, at ¶ 30) The Securities and Exchange Commission consented to the consolidation of its case with SIPC's action against Madoff. (A-42, at ¶ 30) The District Court appointed the Trustee under SIPA § 78eee(b)(3), and referred the case to the Bankruptcy Court pursuant to SIPA § 78eee(b)(4). (A-42, at ¶ 31)

A. The Trustee Was Appointed to Recover Customer Property.

Upon his appointment, the Trustee was vested with the powers enumerated by SIPA and the Bankruptcy Code, including the powers to investigate the circumstances of BLMIS's insolvency, to recover funds to maximize the customer property estate, and to equitably distribute those funds to victimized customers.

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[2] Many of the facts here are similar to those in the similarly situated appeal against the "HSBC defendants," which stem from the same Amended Complaint and the same July 28 Order. The HSBC defendants include HSBC Bank plc, HSBC Holdings plc, HSBC Securities Services (Luxembourg) S.A., HSBC Institutional Trust Services (Ireland) Limited, HSBC Securities Services (Ireland) Limited, HSBC Institutional Trust Services (Bermuda) Limited, HSBC Bank USA, N.A., HSBC Securities Services (Bermuda) Limited, HSBC Bank (Cayman) Limited, HSBC Private Banking Holdings (Suisse) S.A., HSBC Private Bank (Suisse) S.A., HSBC Fund Services (Luxembourg) S.A., and HSBC Bank Bermuda Limited, and are also defendants herein. The Trustee incorporates herein the arguments set forth in his brief filed in Docket No. 11-5207.

(A-46-47, at ¶¶ 44, 48-50) Through his investigation, the Trustee has uncovered evidence of the significant roles of the UniCredit entities and the other defendants in the Ponzi scheme, all of whom caused damage to the customer property estate that the Trustee is obligated to maximize. (A-46-47, at ¶¶ 45-47) SIPC has advanced, to date, approximately $800 million to the Trustee in order to satisfy customer claims.[3] The Trustee seeks in this action to hold the UniCredit entities liable for their conduct.

B. The Relationship Among UniCredit, Bank Austria, Pioneer, and the Other Defendants.

Madoff did not work alone in orchestrating the world's largest Ponzi scheme. When the pool of American investors threatened to run dry, Madoff turned to foreign investors to keep the fraud alive. (A-32-33, at ¶¶ 2-3) One of Madoff's chief ambassadors in Europe was Sonja Kohn, who introduced Madoff to a new audience. (A-33-34 at ¶¶ 5-7; A-48-49, at ¶ 51) Kohn, along with Bank Austria and 20:20 Medici AG ("Bank Medici"), set up several funds—including Primeo Fund, Herald Fund, Herald (Lux) SICAV, Alpha Prime Fund, and Senator Fund (the "Medici Funds")—that directed almost $3 billion of capital into

[3] *See* Seventh Application of Trustee and Baker & Hostetler LLP for Allowance of Interim Compensation for Services Rendered and Reimbursement of Actual and Necessary Expenses Incurred from February 1, 2011 Through May 31, 2011 at 14. *SIPC v. Bernard L. Madoff Inv. Sec. LLC (In re BLMIS)*, No. 08-01789 (Bankr. S.D.N.Y. Sept. 21, 2011) (ECF No. 4376). Information on SIPC's advance is publicly available at http://www.madofftrustee.com/distributions-16.html.

BLMIS's scheme. (A-34, at ¶ 7)

In total, all of the defendants in the Amended Complaint, including the HSBC defendants, directed close to $9 billion of capital into BLMIS's scheme. (A-32, at ¶ 1) The UniCredit entities helped establish and marketed the Medici Funds. (A-34, at ¶ 7; A-54-56, at ¶¶ 70-73, A-57, at ¶ 76)

The UniCredit entities were part of an intricate and convoluted structure that was established, at least in part, to siphon money from Madoff's scheme. Bank Austria, itself a subsidiary of UniCredit, founded Bank Medici (with Kohn) and owns a 25% stake in it. (A-54-55, at ¶ 70) Pioneer is wholly owned by a subsidiary of UniCredit. (A-57, at ¶ 76) UniCredit and Bank Austria helped create and/or control Alpha Prime, Primeo and Senator, and had indirect interests in Herald and Herald (Lux) SICAV. (A-55-56, at ¶¶ 71, 73) At various points in time, Pioneer (replacing BA Worldwide, a subsidiary of Bank Austria) acted as an investment adviser to and/or controlled Primeo. (A-55, at ¶ 72; A-57, at ¶ 76)

These defendants also shared directors and employees, most notably Ursula Radel-Leszczynski, who served as a director of both Primeo and Alpha Prime, and was the President of BA Worldwide from 2000 until at least 2007. (A-67, at ¶ 111) Ms. Radel-Leszczynski was actively involved in the management of Primeo, Alpha Prime and Senator, including managing Madoff's relationship with these funds. (A-67, at ¶ 111) This convoluted network of funds and service providers

was designed to give an appearance of systemic checks and balances. In reality, it merely served to help Madoff evade scrutiny and generate millions in fees for purported administrative and management services—services that Madoff actually provided. (A-33, at ¶ 4)

The UniCredit entities, and the entities and individuals related to them, earned significant fees and revenues for their involvement in the Medici Funds and other Madoff feeder funds. For example, Bank Medici received fees of at least $15 million, and BA Worldwide received fees of at least $68 million. (A-54-55, at ¶¶ 70, 72)

C. UniCredit, Pioneer and Bank Austria Knew About Madoff's Fraud.

The Amended Complaint identifies the staggering extent of BLMIS's facially impossible trading activities. Madoff's unfailing returns were "too good to be true." This was known by outsiders such as the financial institutions that chose not to invest, industry analysts who thought Madoff could be front-running the market, and publications that raised skepticism about his strategy. (A-103-105, at ¶¶ 215-20) It was also known by insiders such as the UniCredit entities, who were privy to a wealth of information about BLMIS through Primeo, as well as through the network of entities operating the Medici Funds. Statements from Pioneer's own employees reveal as much.

The network of companies managing, advising and controlling the Medici Funds provided only a façade of oversight. The UniCredit entities aggresively marketed its funds to new customers, but did not answer even the most basic questions raised about BLMIS, the strategy or the consistent returns. Indeed, just after Madoff's arrest, a senior research analyst at Pioneer wrote, "[w]e should be the professionals protecting investors from this fraud, instead we are full of this and there is not one [due diligence] report in the files except for one in May 2005. Tell me how you survive that as a [fund of funds]." (A-136, at ¶ 314)

The UniCredit entities cannot be shielded by their conscious desire not to probe Madoff and his operations. The signs that Madoff's operation could not be legitimate were obvious even without performing any diligence whatsoever; so much so that mainstream publications like *Barron's* and *Mar/Hedge* questioned Madoff's legitimacy as early as 2001. (A-103-04, at ¶¶ 215-16) Instead of performing due diligence, the UniCredit entities looked the other way and acquiesced to Madoff's "cover-ups," such as keeping his name off of all of their offering materials. (A-76, at ¶¶ 146-47) Nor did they seriously question Madoff's other suspicious practices, such as not identifying counterparties to BLMIS's options transactions (A-95-96, at ¶¶ 190-93) or his atypical and low fee structure, which meant that the hundreds of millions in performance fees Madoff could have

charged went instead to fund managers and service providers like the UniCredit entities. (A-102-03, at ¶¶ 209-14)

Moreover, the impossibility of BLMIS's purported trading activity was evident from the account information that Pioneer and BA Worldwide, at the very least, saw as investment advisers who had access to their customer accounts. Madoff claimed to employ a split-strike conversion strategy (the "SSC Strategy"), which required the purchase of options correlated to stocks he purported to trade. (A-34, at ¶ 36) Madoff could not have traded the volume of options necessary to carry out the SSC Strategy because he would have needed to trade more options than were available in the market. (A-78-84, at ¶¶ 155-60) BA Worldwide, for example, saw that for no fewer than 561 fake transactions, the volume of options traded in its accounts alone exceeded the volume of all available options in the market. (A-79, at ¶ 158) Put differently, the BA Worldwide accounts profited from facially impossible options trades more than 67% of the time.

Further, in connection with the account for Primeo, the fund with which the UniCredit entities perhaps had the most direct involvement, there were no fewer than 141 equity trades executed outside of the daily price range for that stock. (A-84-85, at ¶ 163) In other words, in those instances, Madoff bought stock at a price *below* the daily low and sold stock at a price *above* the daily high. Even when BLMIS purportedly traded within a stock's daily range, Madoff's numbers were

too good to be true: Primeo's account showed purchases of stocks below the daily average 77% of the time and sales above the daily average nearly 71% of the time. (A-92, at ¶ 183)

In addition, the statements for Primeo's account show Madoff "loaning" money to Primeo to make the false trades in its account. These loans totaled well over $100 million and lasted for 662 days. (A-87-88, at ¶ 173) Madoff, of course, never charged interest. No due diligence is required to understand that Primeo was profiting from a sham.

Instead of reacting with suspicion to the indicia of fraud, Pioneer's officials reacted with sarcasm. In a February 2006 email, a senior Pioneer diligence analyst noted that he had never seen any negative numbers from Madoff. (A-39-40, at ¶ 20) Pioneer's Head of Operational Due Diligence responded, "It's the magic of Madoff," (A-39-49, at ¶ 20) and then suggested, "I think a billion dollars in one manager who gives no transparency, whom nobody has seen and who reconciles his own books is a really good idea." (A-39-40, at ¶ 20)

The UniCredit entities acted with callous disregard to the investors and customers they were supposedly advising. While the UniCredit entities profited handsomely from fees for their services (that they never performed), BLMIS customers lost billions to the Ponzi scheme. The fund of customer property is woefully insufficient to fully compensate customers' net equity claims. The

Trustee asserted his claims against the UniCredit entities and the other defendants in an effort to restore the fund of customer property and then create a general estate for all other Madoff victims.

SUMMARY OF THE ARGUMENT

The District Court erroneously dismissed the Trustee's common law claims concluding that: (1) *Redington v. Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978) ("*Redington I*"), *rev'd on other grounds*, 442 U.S. 560 (1979), lacked "any precedential value" and therefore was not binding; (2) *in pari delicto* and *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991) ("*Wagoner*") prevented the Trustee from asserting the common law claims; (3) SIPC does not have a right of equitable subrogation; and (4) the Trustee could not assert a claim for contribution under New York state law. (SPA-17-25)

First, *Redington I*'s holding that a SIPA trustee is a real party in interest that has been recognized as binding precedent by the Supreme Court and the Second Circuit. *See Holmes v. SIPC*, 503 U.S. 258, 271 n.17 (1992); *SIPC v. BDO Seidman, LLP*, 222 F.3d 63, 69 (2d Cir. 2000) (Sotomayor, J.). *Redington I* held that a trustee, as the bailee of the customer property fund, and SIPC, as the subrogee of customer claims, have standing to pursue common law and equitable claims against third parties. These holdings have never been vacated or reversed, and remain the law of this Circuit. And with good reason. As this Court has long recognized, consistent with its decision in *Redington I*, a trustee has exclusive standing to bring claims that are generalized as to customers or creditors; such is

the case here. *See St. Paul Fire and Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688 (2d Cir. 1989) ("*St. Paul*").

Second, *in pari delicto* and *Wagoner* should not be applicable to a SIPA trustee who recovers and marshals customer property, and then equitably distributes it to customers. In a typical bankruptcy where the shareholders of the debtor could be in a position to benefit from the recovery, *in pari delicto* and *Wagoner* impute to the bankruptcy trustee the wrongdoing of the debtor—the intent being to keep the wrongdoers from reaping any benefit from a recovery action. But this is not a typical bankruptcy. A SIPA trustee's role is different from that of a typical bankruptcy trustee. A SIPA trustee marshals assets for the benefit of the customer property estate. Neither the debtor nor its shareholders (nor any wrongdoer) can benefit from any recovery for the customer property estate. As such, the policy concerns behind the application of the equitable doctrine of *in pari delicto* and *Wagoner*—that no wrongdoer should recover—do not exist here. Indeed, because the Trustee is the only party who has standing to assert claims generalized to customers or creditors, applying *in pari delicto* here would impede, not promote, equity.

Third, SIPA grants SIPC equitable and statutory rights of subrogation to recover sums equal to the amounts advanced to customers. 15 U.S.C. § 78fff-3(a). By enacting SIPA, Congress did not intend to preclude or abolish claims for

equitable subrogation. Nor did it intend for its allocation scheme to preclude the Trustee's claim for equitable or statutory subrogation. SIPC has advanced approximately $800 million to satisfy the claims of BLMIS's customers and is therefore entitled to recover from those legally responsible for the damage.

Fourth, the Trustee has the authority to assert a claim for contribution against the UniCredit entities and the other defendants as joint tortfeasors. The Trustee alleges that UniCredit entities engaged in fraud, engaged in conspiracy to commit fraud, aided and abetted BLMIS's breach of fiduciary duty, aided and abetted BLMIS's fraud, and acted in concert with BLMIS in its breach of fiduciary duty. These claims arise under New York law, not SIPA, and thus the claim for contribution for joint liability arises under New York law. Therefore, New York law applies, not federal law. Thus, the District Court erred in dismissing the Trustee's sufficiently pleaded claim for contribution.

Accordingly, the District Court's dismissal of the Trustee's common law claims and contribution claim should be reversed.

STANDARD OF REVIEW

All of the issues presented here were decided by the District Court in connection with a motion to dismiss for lack of standing and/or failure to state a claim for relief pursuant to Fed. R. Civ. P. 12(b)(1) and 12(b)(6). The Second Circuit reviews *de novo* a district court's dismissal of causes of action for failure to state a claim for relief or lack of standing. *Schulz v. U.S. Fed. Reserve Sys.*, 370 F. App'x 201, 202 (2d Cir. 2010); *Fulton v. Goord*, 591 F.3d 37, 41 (2d Cir. 2009).

ARGUMENT

The District Court's July 28 Order incorrectly applies *Wagoner*, confuses concepts of statutory standing and real party in interest, and rejects the binding precedent of this Circuit. It further ignores the substantive relationship between the Trustee, SIPC and the customer property that the Trustee seeks to recover for the benefit of BLMIS customers. The Trustee has standing and is the real party in interest to assert the common law claims on behalf of the customer property estate. *Redington I* is good law; *St. Paul* must be followed; *Wagoner* is inapplicable; SIPC has a right to equitable and statutory subrogation; and, the Trustee has the right to, and has sufficiently pleaded a claim for, contribution under New York law. Accordingly, the District Court's July 28 Order must be reversed in its entirety.

I. *Redington I*'s Holdings on Real Party in Interest Are Good Law.

The Trustee is the real party in interest to assert claims on behalf of the customer property estate and to redress generalized injuries to customer property. In *Redington I*, the Second Circuit held that a SIPA trustee is the bailee of customer property:

> To the extent that customers have claims that have not been satisfied . . . , [customers] retain rights of action against [third parties]. We hold that the Trustee, as bailee, is an appropriate real party in interest to maintain this action on their behalf.

592 F.2d at 625. Any recovery through claims the Trustee asserts as bailee would

repair the customer property estate, and any recovery would be allocated to victimized BLMIS customers.

Redington I did not create the law of bailment. Outside of *Redington I*, a bailee's status to sue as a real party in interest is well-established.[4] *See* Fed. R. Civ. P. 17(a). *Redington I* is a judicial recognition of the special relationship between a SIPA trustee and the fund of customer property. The Trustee's possessory interest in customer property embodies that relationship and allows the Trustee to assert claims to redress injury to that property.[5] *See, e.g.*, 15 U.S.C. § 78fff-2(c)(3).

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[4] In addition, the Trustee pleaded the ability to sue third parties on common law claims based on customer assignments. However, the Trustee apprised the District Court that he had not yet received any such assignments. Despite the prematurity of the issue, the District Court determined that a SIPA trustee, unlike a bankruptcy trustee, could not pursue third parties through assignments. This was a clear error. *See Bankruptcy Servs., Inc. v. Ernst & Young (In re CBI Holding Co., Inc.)*, 529 F.3d 432, 456-59 (2d Cir. 2008) (relying on section 541(a)(7) of the Bankruptcy Code); *see also* 15 U.S.C. § 78fff-1(a) (vesting a SIPA trustee with the same powers as a bankruptcy trustee).

[5] The District Court further erroneously reasoned that a bailment could not exist either because Madoff was a thief or because the bailment occurred prior to the Trustee's interest in the fund of customer property. (SPA-20) However, these distinctions are irrelevant in a SIPA context, *inter alia*, given that the Trustee is the real party in interest charged with recouping customer property.

Moreover, the District Court erroneously held that *Redington I*'s reversal by the Supreme Court on other grounds meant that the Second Circuit lacked subject matter jurisdiction and, therefore, that all of its holdings were invalid. (SPA-17-18) Neither the Supreme Court, nor the Second Circuit, has vacated or reversed *Redington I*'s holdings that a trustee has standing to sue as a bailee of customer property and that SIPC has standing to sue as a subrogee of customer claims. The cases relied upon by the District Court, *e.g.*, *National R.R. Passenger Corp. v. Nat'l Ass'n of R.R. Passengers*, 414 U.S. 453 (1974) (hereinafter "*National Railroad*"), do not alter these conclusions.

A. A SIPA Trustee Has Standing to Sue as a Bailee of Customer Property, and SIPC Has Standing to Sue as a Subrogee of Customers' Claims.

The Trustee is an appropriate real party in interest here. He has standing, as the bailee, to assert common law claims on behalf of the customer property estate. SIPC is also a real party in interest and can assert claims against third parties as the equitable subrogee of customers to whom it made advances for their loss of customer property.[6] The authority for both of these propositions is grounded in the precedential holdings of *Redington I*.

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[6] The Trustee is authorized to enforce SIPC's subrogation rights by virtue of an assignment of these rights from SIPC.

In *Redington I*, a SIPA trustee asserted claims against the accountant of the debtor, alleging that the accountant violated section 17(a) of the Securities & Exchange Act of 1934 (the "Exchange Act") by issuing misleading statements about the debtor's financial condition. *See Redington I*, 592 F.2d at 619-20. The Second Circuit held: (1) a private cause of action exists under section 17(a) of the Exchange Act; (2) a SIPA trustee, as a bailee of customer property, has standing as a real party in interest to assert state law claims to redress damage to customer property; and (3) SIPC can sue as the equitable subrogee of customers to whom it made advances to cover their losses of customer property. *See id*. at 623-25. Each of these holdings was independent of the other.[7] *See id*.

The Second Circuit first determined that a broker's customers have an implied right of action against third parties who violate section 17(a) of the Exchange Act. *See id*. at 623-24. It held that the section was intended to protect the broker's customers, which therefore implied a remedy in the form of a private cause of action for customers. *See id*. at 622-23.

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[7] The District Court stated, "*Redington* does not anywhere hold that a SIPA trustee has standing to pursue *common law claims* against third parties as bailee of customer property." (SPA-19) The District Court was wrong. *Redington I* speaks directly to the Trustee's standing to assert common law claims against third parties—the Trustee is the real party in interest to assert those claims and in fact is the party who has exclusive standing to bring such claims for generalized injuries to customers. *Redington I*, 592 F.2d at 625; *St. Paul*, 884 F.2d at 701.

As to a SIPA trustee's standing to assert common law causes of action, the *Redington I* Court recognized that a SIPA trustee has a right of possession in customer property and the duty to marshal and return that property under SIPA. *See id*. at 624-25. As a bailee, a SIPA trustee has the right to sue "any wrongdoer whom [the customers] could sue themselves." *Id*. at 625. Under the law of bailment, a bailee can vindicate harm to the bailed property based on his possessory interest. *See United States v. Perea*, 986 F.2d 633, 640 (2d Cir. 1993) ("[T]he bailee has a sufficient possessory interest to permit him to 'recover for the wrongful act of a third party resulting in the loss of, or injury to, the subject of the bailment.'") (quoting *Rogers v. Atl., Gulf & Pac. Co.*, 213 N.Y. 246, 258 (1915)).

As to SIPC's subrogation right, the Second Circuit disagreed with the notion that the statutory right of subrogation in SIPA is SIPC's exclusive remedy, and that SIPC would be precluded from asserting any actions against third parties. *Redington I*, 592 F.2d at 624; *see also* 15 U.S.C. § 78fff-3(a). The *Redington I* Court recognized that the existence of a statutory right of subrogation was not "meant to destroy SIPC's general common-law right of equitable subrogation." *Redington I*, 592 F.2d at 624.

> [W]e believe that it is more in keeping with the intent of Congress *that wrongdoers not receive a windfall benefit from the existence of SIPC*, and *that SIPC be able to recoup its losses from solvent wrongdoers*.

Id. (emphasis added).

On appeal, the Supreme Court considered only whether customers have an implied cause of action for damages under section 17(a) against accountants that are required to file reports under that section. *See Touche Ross & Co. v. Redington*, 442 U.S. 560, 562 (1979) ("*Redington II*"). Finding no implied cause of action, the Supreme Court dismissed the trustee's section 17(a) claim for failure to state a claim, and expressly determined that it was unnecessary for it "to reach [the] other rulings by the Court of Appeals." *Id*. at 567 n.9. The Supreme Court declined to consider the Second Circuit's holdings that a SIPA trustee, as bailee of the customer property estate, and SIPC, as subrogee of customer claims, have standing to pursue state law and equitable claims against third parties. *See id.* Significantly, these holdings were neither vacated nor reversed, and remain the law of this Circuit.

The questions presented in *Redington I* were independent and unrelated to one another. A reversal on one issue did not necessitate the reversal, vacation or dismissal of the other holdings. The Supreme Court's reversal of a lower court decision on a question of substantive law is a merits determination that "leave[s] the decisions reached on other grounds intact." *Newdow v. Rio Linda Union Sch. Dist.*, 597 F.3d 1007, 1041 (9th Cir. 2010). Only if a decision is vacated, rather than reversed on other grounds, will it automatically erase the precedential effect of the lower court's decision. *See Brown v. Kelly*, 609 F.3d 467, 476-77 (2d Cir.

2010) (citing cases regarding the difference between vacating and reversing); *see also Century Pines Land Co. v. U.S.*, 274 F.3d 881, 894 n.57 (5th Cir. 2001). The Supreme Court did not vacate the Second Circuit's real party in interest holdings in *Redington I*. *See Redington II*, 442 U.S. at 579. Only if the Supreme Court or the Court of Appeals *en banc* had "overruled, implicitly or expressly" its holdings on real party in interest would those holdings be vacated. Until then, the Second Circuit is bound by *Redington I*. *See BDO Seidman*, 222 F.3d at 69 (quoting *Bank Boston, N.A. v. Sokolowski* (*In re Sokolowski*), 205 F.3d 532, 534-35 (2d Cir. 2000) (*per curiam*) ("This court is bound by a decision of a prior panel unless and until its rationale is overruled, implicitly or expressly, by the Supreme Court or this court *en banc*.")).

The District Court here rejected *Redington I*, reasoning that it lacked "any precedential value." (SPA-17) The District Court claimed that all courts that relied on *Redington I* failed to understand that the Supreme Court's reversal was for "want of subject matter jurisdiction." (SPA-17) The District Court's ruling misconstrues both the scope of the Supreme Court's limited reversal on the merits and the impact of the Supreme Court's ruling in *Redington II*.

B. The Supreme Court's Merits-Based Reversal of *Redington I* Did Not Nullify the Second Circuit's Other Holdings.

The District Court's wholesale rejection of *Redington I*'s bailment and subrogation holdings goes far beyond the Supreme Court's decision in *Redington II*, which was limited to a merits-based reversal on the issue of whether a private right of action existed under section 17(a) of the Exchange Act. *See Redington II*, 442 U.S. at 567. The remainder of the Second Circuit's decision—that the trustee and SIPC were appropriate real parties in interest—was left untouched. *See Redington I*, 592 F.2d at 625.

Nonetheless, the District Court rejected *Redington I*, wrongly reasoning that dismissal for failure to state a claim resulted in a lack of subject matter jurisdiction. (SPA-17-18) The failure to state a claim, however, does not equate to a lack of subject matter jurisdiction:

> It is firmly established in our cases that the absence of a valid (as opposed to arguable) cause of action does not implicate subject-matter jurisdiction, *i.e.*, the courts' statutory or constitutional *power* to adjudicate the case.

Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 89 (1998) (citing 5A Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1350 (2d ed. 1990)); *see also Bell v. Hood*, 327 U.S. 678, 682 (1946) ("[J]urisdiction . . . is not defeated . . . by the possibility that the averments might fail to state a cause of action on which petitioners could actually recover.").

The *Redington I* Court had the requisite federal jurisdiction to make a merits-based inquiry into whether a private right of action existed under section 17(a) of the Exchange Act because that question involved interpreting the laws of the United States. *See Platzer v. Sloan-Kettering Inst. for Cancer Research*, 787 F. Supp. 360, 363 (S.D.N.Y. 1992), *aff'd*, 983 F.2d 1086 (Fed.Cir 1992) (citing *Bell*, 327 U.S. at 682); *see also Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2877 (2010); *Steel Co.*, 523 U.S. at 89; *New York Stock Exch., Inc. v. Sloan*, No. 71 Civ. 2912, 1980 WL 1431, at *5 (S.D.N.Y. Aug. 15, 1980). When no private right of action exists, a court will dismiss the case for failure to state a claim—not for want of subject matter jurisdiction. *See Morrison*, 130 S. Ct. at 2877;[8] *Chenkin v. 808 Columbus LLC*, 368 F. App'x 162, 163 (2d Cir. 2010), *cert. denied*, 131 S. Ct. 796 (2010); *Rodriguez ex rel. Rodriguez v. DeBuono*, 175 F.3d 227, 233 (2d Cir. 1999); *Platzer*, 787 F. Supp. at 363-64. Subject matter jurisdiction is not determined when a claim is dismissed on the ground that a statute does not support a private right of action; it remains an issue for the parties to later contest, if

[8] Here, the District Court rejected the application of *Morrison*, claiming that the issue in that case was "whether an accepted cause of action brought under § 10(b) was properly plead[ed], [and] not whether a private right of action existed at all." (SPA-18, at n. 7) However, as Justice Scalia made clear, the Supreme Court granted *certiorari* in *Morrison* to decide if a particular provision of the "Securities Exchange Act of 1934 provide[d] a cause of action . . . ." *Morrison*, 130 S. Ct. at 2875. Similarly, *Redington I* and *Redington II* determined whether a private right of action existed under section 17(a), not whether that claim was properly pleaded. *See Redington I*, 592 F.2d at 621; *Redington II*, 442 U.S. at 562.

appropriate. *See Northwest Airlines, Inc. v. County of Kent, Mich.*, 510 U.S. 355, 365 (1994); *Rodriguez*, 175 F.3d at 233; *24 Hour Fuel Oil Corp. v. Long Island R.R. Co.*, 903 F. Supp. 393, 396 (E.D.N.Y. 1995).

The Supreme Court made no determination in *Redington II* that the lower court lacked subject matter jurisdiction. Nor did the Supreme Court in any way suggest that the Second Circuit did not have subject matter jurisdiction in *Redington I* to make its other rulings. Indeed, in *Redington II*, having determined that section 17(a) of the Exchange Act did not imply a private right of action, the Supreme Court dismissed the claim for failing to state a claim for relief, and remanded the matter to the Second Circuit "for a decision on the Trustee's alternative bases for jurisdiction." *Redington v. Touche Ross & Co.*, 612 F.2d 68, 70 (2d Cir. 1979) ("*Redington III*"). On remand, the Second Circuit dismissed the state law claims because the court elected not to exercise pendent jurisdiction over the remaining state law claims against the accountant. *See id.* at 70, 72-73.

The Second Circuit's opinion in *Motorola Credit Corp. v. Uzan*, 388 F.3d 39 (2d Cir. 2004), further explains the distinction between a merits-based dismissal for failure to state a claim and a dismissal for lack of subject matter jurisdiction. The Second Circuit held, on the merits, that plaintiffs lacked statutory standing to assert a federal RICO claim—the single federal claim asserted. It dismissed the RICO claim for failure to state a claim. The Second Circuit did not find that the

lower court lacked subject matter jurisdiction and, in fact, remanded the case to the district court to allow it to determine whether to retain jurisdiction. *See id.* at 55 ("[W]e dismissed Motorola's RICO claim on the merits rather than for lack of subject-matter jurisdiction."). On remand, the district court, in its discretion, exercised supplemental jurisdiction over the remaining state law claims. *See id.* at 47.

The *Motorola* and *Redington* cases demonstrate the District Court's error in relying upon *National Railroad* for the proposition that standing can never be determined separately from the question of whether a private right of action exists. (SPA-18, at n.7) The District Court failed to recognize that the *National Railroad* Court's refusal to make a statutory standing determination was distinctly different from the Second Circuit's holdings on real party in interest in *Redington I*. *See National Railroad*, 414 U.S. at 456.

In *National Railroad*, the Supreme Court considered whether the National Association of Railroad Passengers ("NARP") could maintain a private cause of action under the Rail Passenger Service Act of 1980 (the "Amtrak Act"). The single federal claim asserted was the only claim presented; no additional state common law claims were involved. *See id.* If there were a private right of action under the Amtrak Act, the interrelated question was whether NARP would have had standing under the statute to assert the cause of action. *See id.* The Supreme

Court held that there was no private right of action. *See id.* at 456, 464-65. As such, the Supreme Court determined that "questions of standing and jurisdiction bec[a]me immaterial," and did not rule on them.[9] *See id.* at 465 n.13.

Neither this case nor *Redington I* was limited to a single federal statute as in *National Railroad*. *Redington I* and this case involve common law determinations of whether a SIPA trustee is a real party in interest to assert state common law claims on behalf of the customer property estate—not whether a party has statutory standing.[10] Accordingly, a determination on the existence of a private right of action tied to a federal statute does not end the court's inquiry into a trustee's

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[9] In *Steel Co.*, the Supreme Court reiterated that *National Railroad* involved only the question of whether a statutory cause of action existed and did not address other standing concerns. 523 U.S. at 96-97.

[10] The standing issue addressed on *National Railroad* was statutory standing, not standing to assert common law claims. Whether a statute creates a right of action and whether a party has standing under the statute are intertwined merits-based determinations that are separate and distinct from questions of constitutional standing and its prudential limitations. *See Graden v. Conexant Sys., Inc.*, 496 F.3d 291, 295 (3d Cir. 2007); *Steel Co.*, 523 U.S. at 97. Questions of standing and real party in interest require a court to determine the proper party to assert a claim to redress the alleged injuries. (SPA-4-5); *Energy Transp., Ltd. v. M.V. San Sebastian*, 348 F. Supp. 2d 186, 196 (S.D.N.Y. 2004) (noting that the doctrine of standing and the determination of a real party in interest are interrelated issues because both involve the issue of "who may initiate a claim"). As the District Court here recognized, referring to prudential limitations on standing, "a party must assert his own legal rights and interests." (SPA-5) But, as *Redington I*, *Redington II* and *Redington III* aptly demonstrate, the Trustee is a real party in interest, as the bailee of customer property, and SIPC is a real party in interest, as the subrogee for advances to customers. As such, they are authorized to assert claims against third parties to recover customer property.

standing to assert state common law claims.

National Railroad can be further distinguished from the *Redington* cases. In *National Railroad*, whether the Amtrak Act created a private right of action and whether the respondent had standing to bring that action were virtually the same question, or at least were inextricably intertwined, as both required an analysis of the statute. 414 U.S. at 455-57. By contrast, in *Redington I*, the Second Circuit addressed the question of whether a SIPA trustee is a real party in interest as a bailee of customer property and whether SIPC is a subrogee, independent of whether section 17(a) of the Exchange Act created a private right of action. Whether the trustee and SIPC were real parties in interest who could assert the common law claims asserted in *Redington I* was not at all dependent on, or intertwined with, the interpretation of the Exchange Act. Therefore, unlike *National Railroad*, *Redington I*'s holdings on the common law claims were not inextricably intertwined with the finding that there was no private right of action under section 17(a) of the Exchange Act, and therefore remain binding precedent.

C. Decisions Since *Redington I* Reinforce its Precedential Value.

Redington I established the principle that a SIPA trustee has standing as a bailee and that SIPC has standing as a subrogee.[11] *See, e.g.*, *Appleton v. First Nat'l Bank of Ohio*, 62 F.3d 791, 800 n.7 (6th Cir. 1995); *Giddens v. D.H Blair & Co. (In re A.R. Baron & Co., Inc.)*, 280 B.R. 794, 805 (Bankr. S.D.N.Y. 2002); *SIPC v. Cheshier & Fuller, L.L.P. (In re Sunpoint Sec., Inc.)*, 377 B.R. 513, 550 (Bankr. E.D. Tex. 2007), *aff'd sub. nom. Richardson v. Cheshier & Fuller, LLP*, No. 6:07 Civ. 256, 2008 WL 5122122 (E.D.Tex. 2008).

Courts within the Second Circuit repeatedly have recognized *Redington I* as precedent. *See SIPC v. BDO Seidman, LLP*, 222 F.3d at 69; *SIPC v. BDO Seidman, LLP*, 49 F. Supp. 2d 644, 652 (S.D.N.Y. 1999), *aff'd in part*, 222 F.3d 63 (2d Cir. 2000); *Picard v. Taylor (In re Park S. Sec., LLC)*, 326 B.R. 505, 516 (Bankr. S.D.N.Y. 2005). The Supreme Court has implicitly acknowledged the precedential value of *Redington I*. *See Holmes,* 503 U.S. at 271 n.17.

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[11] The District Court mistakenly relies on *Mishkin v. Peat, Marwick, Mitchell & Co.*, 744 F. Supp. 531 (S.D.N.Y. 1990) ("*Mishkin*"), to support its holding that *Redington I* is no longer good law. (SPA-18) *Mishkin* addressed only the issue of subrogation (an express right of SIPC) and never reviewed or determined whether a trustee could sue as the bailee of customer property. *See generally Mishkin*, 744 F. Supp. at 556-58. Moreover, *Mishkin* did not address whether *Redington II* deprived *Redington I* of precedential value, but rather impermissibly overruled *Redington I*, leading other courts to find *Mishkin* to be an outlier opinion. *See Appleton v. First Nat'l Bank of Ohio*, 62 F.3d 791, 799-800 (6th Cir. 1995).

Redington I's holdings identifying the real parties in interest are good law. Accordingly, the District Court's dismissal of the Trustee's common law claims was erroneous and should be reversed.

D. The District Court Redefined the Scope of *Redington I.*

The District Court erroneously reasoned that even if *Redington I* were good law, its ruling would be limited to the specific facts of that case. The circumstances in *Redington I* that led to the Second Circuit's holding that the trustee was a real party in interest to assert common law claims for negligence, malpractice, breach of warranty, and breach of contract are no different from those at issue here.[12] There, as here, customers invested funds with a broker-dealer engaged in fraudulent activities, a third party took actions that perpetuated the

[12] The District Court attempts to distinguish this case from *Redington I*. The District Court's findings are contradictory to the allegations pleaded in the Trustee's Amended Complaint which, on a motion to dismiss, the court must accept as true. First, it claims that the impact of HSBC's actions resulted in "a gain in the value" of the bailment and did not cause damages in the same manner as those of the accountant in *Redington I*. (SPA-21) Not only was this beyond the scope of the matters for which the District Court withdrew the reference, but also, in reaching this factual finding, the District Court substituted its own musings for the facts as pleaded. The Amended Complaint plainly states that the flow of funds from HSBC "helped to perpetuate Madoff's Ponzi scheme, thus deepening the insolvency of BLMIS and perpetuating Madoff's fraud." (A-74-75, at ¶ 141) The District Court also states that *Redington I* involved damages to the broker-dealer's *own* accountant, whereas HSBC "provides no direct service to Madoff Securities" or its customers. (SPA-19-20) However, the Amended Complaint pleads intentional torts, which renders irrelevant the District Court's improper findings of fact; simply put, the stated duty, or lack thereof, is irrelevant to the Trustee's common law claims.

fraud, the broker-dealer was put into liquidation, and a SIPA trustee was appointed. *Redington I*, 592 F.2d at 620. Based on these facts and a SIPA trustee's duties, the Second Circuit determined that the trustee was a real party in interest and could maintain an action against the third party for injuries that occurred prior to the liquidation. *Id.* at 625. Indeed, SIPA anticipates the fraudulent activities of broker-dealers, and thus defines customer property to include cash and securities "at any time received," and property "unlawfully converted." 15 U.S.C. § 78*lll*(4). Accordingly, the Trustee must consider the events and circumstances that led to the failure of BLMIS and pursue actions to redress injuries to the fund of customer property.

II. A SIPA Trustee Has Exclusive Standing to Assert Common Law Causes of Action That Generally Affect All Customers.

Relying on *Caplin v. Midland Grace Trust Co.*, 406 U.S. 416 (1972), the District Court dismissed the Trustee's common law claims, holding that a trustee lacks standing to sue third parties on behalf of the bankrupt estate's creditors. (SPA-5, 8-9) The District Court's holding is erroneous.

The Second Circuit's decision in *St. Paul* controls under the circumstances here. Under *St. Paul* and its progeny, a SIPA trustee has exclusive standing to assert claims to redress common injuries suffered by all customers—"generalized claims." *Id.* The *St. Paul* Court recognized that Congress intended that a trustee

should be able to assert generalized creditor claims against the debtor, alter egos of the debtor, or "others who have misused the debtor's property in some fashion." *Id.* The *St. Paul* Court held that:

> If a claim is a general one, with no particularized injury arising from it, and if that claim could be brought by any creditor of the debtor, *the trustee is the proper person to assert the claim, and the creditors are bound by the outcome of the trustee's action.*

Id. (emphasis added). A claim is generalized when it can be brought by any creditor; it is particularized when it can *only* be brought by a specific creditor or a small group of creditors. *Koch Ref. v. Farmers Union Cent. Exch., Inc.*, 831 F.2d 1339, 1348-49 (7th Cir. 1987). The *St. Paul* Court reasoned that permitting a trustee to assert generalized creditor claims against third parties "would have the effect of bringing the property of the third party into the debtor's estate, and thus would benefit all creditors." 884 F.2d at 701.

The Court further reasoned that the trustee's exclusive standing to pursue claims common to the creditors would protect against duplicative litigation and inconsistent judgments on the same claim:

> If the trustee is the only one with standing to bring a certain action, because of the generalized nature of the injury, it follows that those who are barred from bringing

> that same action in an independent proceeding should and will, under bankruptcy law, be bound by the outcome of the trustee's suit.

Id. at 700. The trustee's exclusive standing avoids the danger of inconsistent results through the lawsuits of individual creditors. *See id.*

Moreover, *St. Paul*'s holding is especially relevant in the context of a Ponzi scheme where each creditor holds "other people's money." If only some creditors sued and recovered, others would be disadvantaged. The inevitable race to the courthouse would eviscerate the "net investment method" established by the Trustee and upheld by the Second Circuit. *See generally In re Bernard L. Madoff Inv. Sec. LLC,* 654 F.3d 229 (2d Cir. 2011), *petition for cert. filed*, __ U.S.L.W. __ (Feb. 3, 2012) (Nos. 11-968, 11-969) ("*Net Equity Decision*").

St. Paul is not inconsistent with *Caplin*, the case cited by the District Court for the proposition that the Trustee lacks standing to bring claims on behalf of BLMIS customers. (SPA-5, 8-9) *Caplin* stands for the straightforward proposition that a trustee representing the debtor's estate cannot assert *individualized* claims of certain creditors. *See* 406 U.S. at 434. It does not apply to a trustee asserting a generalized claim on behalf of all creditors. In *St. Paul*, the Second Circuit directly addressed *Caplin*, finding that *Caplin* does not control when a trustee is asserting a claim to redress a *generalized* injury. *See St. Paul*, 884 F.2d at 700; *see also Koch Ref.*, 831 F.2d at 1347 n.11 (*Caplin* "does not affect a trustee's right to bring a

general action on behalf of all creditors rather than a personal one on behalf of only some.”). *Caplin* therefore is inapplicable here.

St. Paul remains the precedent in this Circuit and should be followed. *See Kagan v. St. Vincents Catholic Med. Ctrs. (In re St. Vincents Catholic Med. Ctrs.)*, 449 B.R. 209, 217 (S.D.N.Y. 2011) (creditor’s claim against third party violates the automatic stay because the trustee is the proper person to pursue claims for injuries that are generalized to all creditors); *Labarbera v. United Crane & Rigging Servs.*, Nos. 08-cv-3274, 08-cv-3983, 2011 WL 1303146, at *6 (E.D.N.Y. Mar. 2, 2011) (citing *St. Paul* and holding, “[w]here the harm suffered by the claimant is no different than the harm suffered by other creditors, the action belongs to the trustee or debtor-in-possession”); *Cohain v. Klimley*, Nos. 08 Civ. 5047, 09 Civ. 4527, 09 Civ. 10584, 2010 WL 3701362, at *10 (S.D.N.Y. Sept. 20, 2010) (relying on *St. Paul* and holding that avoidance actions and common law claims are the “sole responsibility of the trustee” and “further[ ] the fundamental bankruptcy policy of equitable distribution among creditors”); *Green v. Bate Records, Inc. (In re 10th Ave. Record Distrib., Inc.)*, 97 B.R. 163, 165-66 (S.D.N.Y. 1989) (recognizing that the Second Circuit has concluded that bankruptcy trustees “have standing to assert . . . claims [that] benefit the entire estate in bankruptcy and are not particular to one creditor or group of creditors.”).

Here, the Trustee has asserted common law claims against the UniCredit entities and the other defendants. These are generalized claims because they would redress common injuries to BLMIS customers; injuries incurred as a result of the UniCredit entities' and the other defendants' malfeasance. The Trustee's claims against the UniCredit entities are not claims that belong to a specific BLMIS customer or creditor. Indeed, neither the UniCredit entities nor the District Court identified any such customer or creditor. *St. Paul* therefore governs and provides the Trustee with exclusive standing to pursue the common law claims.

III. The District Court Erred in Applying *Wagoner* to Divest the Trustee of Standing to Assert Common Law Claims.

When the District Court below held that *Wagoner* and the doctrine of *in pari delicto* deprive the Trustee of standing to bring common law claims in federal court, it stripped the Trustee—and BLMIS customers—of the ability to hold the UniCredit entities and the other defendants liable for their complicity in the Ponzi scheme. (SPA-22-24) The District Court concluded, without any discussion of the UniCredit entities' conduct, that Madoff's conduct should be imputed to the Trustee. (SPA-23) The District Court further concluded that no exception to *in pari delicto* could exist and that the conduct of Madoff and his "now-defunct company," neither of which stands to profit from the Trustee's action, barred the Trustee from asserting common law claims. (SPA-23-24) The District Court's

holdings, however, ignored the limitations of *Wagoner*'s application and the equitable considerations that drive both the doctrine of *in pari delicto* and SIPA. *See, e.g.*, *Peltz v. SHB Commodities, Inc.*, 115 F.3d 1082, 1090 (2d Cir. 1997); *Koch Indus., Inc. v. Hoechst Aktiengesellschaft*, 727 F. Supp. 2d 199, 212-13 (S.D.N.Y. 2010); *Kirschner v. KPMG, LLP*, 15 N.Y.3d 446, 474 (2010).

A. *Wagoner* Is Not Applicable to a SIPA Trustee.

Wagoner did not involve a SIPA trustee, but rather, a bankruptcy trustee who sought, on behalf of individual customers, a second bite at the apple for claims that were time-barred and had been previously disposed of in an arbitration. *See Wagoner*, 944 F.2d at 117-19. The claims barred in *Wagoner*, unlike the Trustee's common law claims here, were the individualized claims of certain creditors. Those claims are unlike the Trustee's common law claims, which are generalized claims intended to redress damage to the customer property fund. These claims can only be asserted by a SIPA trustee. *See supra* Point II. *Wagoner* is therefore inapplicable here.

B. A SIPA Trustee Is Appointed to Restore the Customer Property Estate.

A SIPA trustee is the appropriate party in interest to assert common law claims on behalf of the customer property estate. This right is predicated on the distinct duties and the unique authority of a SIPA trustee. It is this authority and

those duties that empower a SIPA trustee to assert common law claims on behalf of the customer property estate.

As the Second Circuit recognizes, the customer property estate and the general estate in a SIPA liquidation are separate estates with distinct characteristics and purposes. *Net Equity Decision*, 654 F.3d at 233; *Rosenman Family, LLC v. Picard*, 395 F. App'x 766, 768 (2d Cir. 2010). The customer property estate is comprised of recovered assets intended to satisfy customer claims.[13] SIPA § 78*lll*(4); *Rosenman*, 395 F. App'x at 768; *In re Adler Coleman Clearing Corp.*, 195

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[13] Before 1938, customers of a bankrupt stockbroker who could not trace their cash and securities to the debtor's possession were treated as general creditors. *See* Report of Special Study of Securities Markets of the Securities Exchange Commission ("1963 SEC Report"), H.R. Doc. No. 95, at 411 (1963). Thus, a customer's right to recover "depend[ed] largely upon the fortuitous circumstances that stock of [one customer was] on hand, while that of another customer in the exact same relationship may not [have been] on hand." *Revision of the Bankruptcy Act: Hearings on H.R. 6439 and H.R. 8046 Before the H. Comm. on the Judiciary*, 75th Cong. 96 (1937) ("1937 Hearing on Revision of Bankruptcy Act"). In response to this inequitable treatment of customers, Congress enacted section 60e of the Chandler Act.

Under that section, all customers—regardless of whether their property was specifically identifiable—would share *pro rata* in a single and separate fund. To the extent that the single and separate fund could not satisfy the claims of all customers, the trustee of a bankrupt stockbroker was charged with restoring the fund to what it should have been on the filing date and then ratably distributing the recovered fund assets to customers. *See* 1963 SEC Report, at 412. After a spate of stock brokerage insolvencies, Congress enacted SIPA to replace those provisions. *See* S. Rep. No. 91-1218, at 2-4 (1970); *see also* H.R. Rep. No. 91-1613, at 2-4, 10 (1970), *reprinted in* 1970 U.S.C.C.A.N. 5254, 5255-57; *SIPC v. Barbour*, 421 U.S. 412, 415 (1975).

B.R. 266, 270 (Bankr. S.D.N.Y. 1996). By contrast, the general estate is intended to satisfy the claims of general unsecured creditors. The customer property estate cannot be used to satisfy general unsecured creditors' claims. *See Adler Coleman*, 195 B.R. at 270.

SIPA is chiefly concerned with the customer property estate. *See, e.g.*, *SEC v. First Sec. Co. of Chi.*, 507 F.2d 417, 420 (7th Cir. 1974) (SIPA was enacted "to protect, and secure equality of treatment for, 'the public customer . . . .'") (quoting *SEC v. F.O. Baroff Co., Inc.*, 497 F.2d 280, 283 (2d Cir. 1974)). Indeed, the primary purpose of a SIPA liquidation proceeding is to appoint a trustee to maximize the customer property estate and to distribute such property to the customers of the debtor to the extent of their net equity claims. *See* 15 U.S.C. § 78fff(a)(1)(B); *SEC v. Albert & Maguire Sec. Co.,* 560 F.2d 569, 573-74 (3d Cir. 1977); *see also Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1986). In contrast, a bankruptcy trustee's duty "to administer a debtor's property, on behalf of the debtor's creditors, however, *only extends to estate property*." *Old Trail Ltd., Inc. v. Graham (In re Weldon Stump & Co.)*, 383 B.R. 435, 438 (Bankr. N.D. Ohio 2008) (emphasis added).

C. *In Pari Delicto* Does Not Apply to a SIPA Trustee Who Proceeds on Behalf of the Customer Property Estate.

A SIPA trustee who seeks to recover assets for the benefit of a debtor's customers should not be impeded by the doctrine of *in pari delicto*. *See Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (*in pari delicto* should not interfere with enforcement of securities laws and protection of the investing public). *In pari delicto* allows a court faced with resolving a dispute between equally culpable wrongdoers to decline to intercede because the court should not lend its good offices to wrongdoers. *See Kirschner*, 15 N.Y.3d at 464. The policy behind *in pari delicto* is rooted in principles of equity, namely that courts should not permit a wrongdoer, fraudster or criminal to profit further from his wrongdoing by asserting claims for damages against other equally culpable parties. *Id.* The equities disfavor applying *in pari delicto* when the doctrine would yield inequitable results. *Bateman Eichler*, 472 U.S. at 310.

Given the nature of the Trustee's appointment, the policy concerns underlying *in pari delicto* are absent here. The Trustee is, of course, not a wrongdoer himself. Further, the Trustee is the only party who can assert claims to redress damage to the customer property estate. *See supra* Point II. By imputing Madoff's wrongdoing to the Trustee, the District Court impeded the Trustee's duties and powers under SIPA and his right to assert common the harm the UniCredit entities inflicted upon the customer property fund. The UniCredit

entities prolonged and expanded the Ponzi scheme, increasing the damage done to customers whose property was dissipated as the Ponzi scheme endured. The Trustee's ability to assert common law claims is critical to recovering funds for distribution to the victims of a decades-long Ponzi scheme.

"[T]he defense of *in pari delicto* [lost] its sting" when the Trustee was appointed under SIPA and Madoff was "ousted from control of and beneficial interest in" BLMIS. *See Scholes v. Lehmann*, 56 F.3d 750, 754-55 (7th Cir. 1995) (citing *McCandless v. Furlaud*, 296 U.S. 140, 160 (1935) (Cardozo, J.) (refusing to impute the bad acts of corporate promoters, shareholders and agents to the corporation)). The Trustee should not be tainted by Madoff's wrongdoing. *See, e.g.*, *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) (holding that the misconduct of a failed bank should not be imputed to a receiver appointed to pursue state law claims and declining to apply *in pari delicto*); *McNamara v. PFS (In re The Personal and Business Ins. Agency)*, 334 F.3d 239, 245-47 (3d Cir. 2003) (holding that trustee was not tainted by debtor's fraud).

Further, no debtor, insider or any other wrongdoer will benefit from the Trustee's recovery of customer property. Congress has made clear that a person engaged in illegal or improper conduct is not given the protection that a customer would receive. "[A] customer [who] has acted improperly or illegally . . . may be denied SIPC protection." *SIPA Amendments: Hearings on H.R. 8064 Before the*

Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 94th Cong. 169, 171-72 (1975) ("1975 SIPA Amendment Hearings").

Courts uniformly have held that SIPA is intended to safeguard only innocent investors. "One who engages in a fraudulent transaction cannot reap the benefits of the Act's intended protection." *SEC v. Packer, Wilbur & Co., Inc.*, 498 F.2d 978, 984 (2d Cir. 1974); *SEC v. N. Am. Planning Corp.*, No. 72 Civ. 3158, 1975 WL 346, at *2 (S.D.N.Y. Jan. 24, 1975); *Mishkin v. Siclari (In re Adler, Coleman Clearing Corp.)*, 277 B.R. 520, 558 (Bankr. S.D.N.Y. 2002).

SIPA's definition of customer also excludes the debtor's shareholders. 15 U.S.C. § 78*lll*(2)(B). To preserve the sanctity of the customer property estate, Congress declined to permit "shareholders of the debtor and any persons who have subordinated their claims to those of other creditors" to have the protections of customers. *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the H. Comm. on the Judiciary*, 94th Cong. 2314 (1976). By excluding the debtor's shareholders and subordinated lenders, SIPA excludes those most readily positioned to engage in wrongdoing. *1975 SIPA Amendment Hearings*, at 182. Thus, the wrongdoers that *in pari delicto* is designed to bar from recovery will not benefit from distributions of customer property under SIPA, and the doctrine should not apply here.

D. The District Court Erred by Applying *In Pari Delicto* on the Pleadings.

The District Court erred in ruling, solely on the pleadings, that *in pari delicto* bars the Trustee from asserting common law claims. (SPA-22-24) Courts should not apply *in pari delicto* before allowing an opportunity for pertinent discovery. *See, e.g.*, *Stanziale v. McGladrey & Pullen, LLP (In re Student Fin. Corp.)*, No. 02-11620, 2006 WL 2346373, at *2 (D. Del. Aug. 10, 2006); *OHC Liquidation Trust v. Credit Suisse First Boston (In re Oakwood Homes Corp.)*, 340 B.R. 510, 536 (Bankr. D. Del. 2006). Because the doctrine requires a court to assess factual questions, like the comparative fault of the wrongdoers, dismissal of a claim on the basis of *in pari delicto* is disfavored, absent discovery on that issue. *See, e.g.*, *Pinter v. Dahl*, 486 U.S. 622, 635 (1988); *Bateman Eichler*, 472 U.S. at 310-11; *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990). The doctrine should not be applied mechanically because it yields inequitable results. *See Bankruptcy Servs., Inc. v. Ernst & Young (In re CBI Holding Co., Inc.)*, 529 F.3d 432, 443 (2d Cir. 2008); *Krys v. Sugrue (In re Refco Sec. Litig.)*, 779 F. Supp. 2d 372, 375 (S.D.N.Y. 2011); *Official Comm. of Unsecured Creditors of Grumman Olson Indus., Inc. v. McConnell (In re Grumman Olson Indus., Inc.)*, 329 B.R. 411, 425 (Bankr. S.D.N.Y. 2005). Before imposing *in pari delicto*, courts are required to carefully examine the equities among the parties and whether exceptions to the doctrine should apply. *See, e.g., Bateman Eichler,* 472 U.S. at 310; *Buckley v.*

Deloitte & Touche USA LLP, No. 06 Civ. 3291, 2007 WL 1491403, at *1, *8 (S.D.N.Y. May 22, 2007); *Hirsch v. Tarricone* (*In re A. Tarricone)*, 286 B.R. 256, 262 (Bankr. S.D.N.Y. 2002); *Pan Am. Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438, 499 (S.D.N.Y. 1994); *Bruno Machinery Corp. v. Troy Die Cutting Co., LLC (In re Bruno Machinery Corp.*), 435 B.R. 819, 833 (Bankr. N.D.N.Y. 2010).

Here, the District Court declined to address the complicated factual questions about the UniCredit entities' role in the Ponzi scheme. By dismissing on the pleadings, the District Court denied the Trustee the ability to demonstrate the comparative fault of the UniCredit entities. *See McHale v. Citibank, N.A. (In re 1031 Tax Group, LLC)*, 420 B.R. 178, 194 (Bankr. S.D.N.Y. 2009) ("The problem is that exceptions to the application of *in pari delicto* . . . can make it exceedingly difficult to resolve a case on a motion for lack of standing . . . [under] *Wagoner*."). When such "complex, fact-based issues abound, pre-answer dismissal should be an exception, not the rule." *Ross*, 904 F.2d at 824; *see also Kirschner*, 15 N.Y.3d at 478 (citing *Morgado Family Partners, LP v. Lipper*, 19 A.D.3d 262, 263 (1st Dept. 2005)).

By applying *in pari delicto* to bar the Trustee's standing, the District Court also, in error, placed the burden of pleading and proof upon the Trustee; had the Court applied *in pari delicto* under New York state law as an affirmative defense, the UniCredit entities would have had the burden of pleading and proof. *See*

Kirschner, 15 N.Y.3d at 478 (citing *Woods v. Roundout Valley Cent. Sch. Dist. Bd. of Educ.*, 466 F.3d 232, 237 (2d Cir. 2006)). The consequences are significant. *See, e.g.*, *Schertz-Cibolo-Universal City Indep. School Dist. v. Wright (In re Educators Grp. Health Trust)*, 25 F.3d 1281, 1286 (5th Cir. 1994) ("That the defendant may have a valid [*in pari delicto*] defense on the merits of a claim . . . goes to the resolution of the claim . . . not to the ability of the debtor to assert the claim."). Given that this was a challenge to the Trustee's complaint, the Trustee's allegations should have been given the utmost deference and certainly should not have been dismissed solely on the pleadings.

The Trustee should not be burdened with the inequitable imposition of a doctrine intended to admonish wrongdoers. The Trustee is not a wrongdoer, fraudster or criminal. Nor will any parties complicit with the wrongdoer benefit from the customer property estate. The purpose of *in pari delicto* is simply not present, and this Court should reject the notion that it should be applied here.

IV. SIPA Authorizes SIPC to Pursue Equitable and Statutory Subrogation Claims Against Third-Party Tortfeasors.

To expedite the payment of net equity claims to customers injured by an insolvent broker-dealer, SIPA requires SIPC to advance to the Trustee up to $500,000 for each customer. 15 U.S.C. § 78fff-3(a). The Trustee uses these advances to satisfy customer claims "for the amount by which the net equity of

each customer exceeds his ratable share of customer property." *Id.* SIPC has advanced, to date, approximately $800 million to the Trustee under this provision. In exchange, SIPA grants SIPC equitable and statutory rights of subrogation to recover sums equal to the amounts advanced to customers. *Id.* In this case, SIPC has expressly assigned to the Trustee the right to enforce SIPC's rights of subrogation with respect to advances it has made, and is making, to customers of BLMIS from SIPC funds. (A-47-48, at ¶ 50(h))

A. The District Court Erred in Holding That SIPC's Subrogation Rights Were Limited and That the Trustee, as Assignee of SIPC's Rights, Does Not Have Standing to Enforce Those Rights.

SIPA § 78fff-3(a) provides that:

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

15 U.S.C. § 78fff-3(a) (emphasis added). Rather than give meaning to the plain language of the statute, the District Court limited SIPC's statutory and equitable rights of subrogation. The District Court first erroneously found that SIPA "makes clear that SIPC is only subrogated to customer *net equity claims against the estate*, not to all customer claims against third parties." (SPA-15) The District Court also

erroneously determined that any implied right of subrogation against third parties would "subvert" the "priority provision" in SIPA § 78fff-2(c)(1), because "SIPC cannot recover as subrogee until the customers are made whole." (SPA-15) Lastly, the District Court erroneously concluded that although SIPA § 78fff-3(a) grants SIPC "all other rights it may have in law or in equity," SIPC does not have a right of equitable subrogation because this right would also contradict the allocation scheme set forth in SIPA § 78fff-2(c)(1) by permitting SIPC to recover before customers' net equity claims had been paid in full. (SPA-15-16) The District Court's wholesale rejection of SIPC's right to assert equitable and statutory subrogation claims in the proceeding below was legal error.

1. SIPC Has a Right of Equitable Subrogation That Allows it to Assert Common Law Claims Against Third Parties.

The District Court erred in holding that SIPC lacks standing under principles of equitable subrogation. In exchange for making advances to BLMIS customers under SIPA § 78fff-3(a), SIPC has the right to pursue both its express right of subrogation and "all other rights it may have at law or in equity." 15 U.S.C. § 78fff-3(a). These "other rights" include the right to pursue claims against third parties as an equitable subrogee.

Equitable subrogation recognizes that a person who pays for another's loss steps into that person's shoes, and has the opportunity to recover from whoever is liable for that loss. *See Fasso v. Doerr*, 12 N.Y.3d 80, 86 (2009); *Rink v. State*, 901 N.Y.S.2d 480, 482 (N.Y. Ct. Cl. 2010), *aff'd*, 929 N.Y.S.2d 903 (4th Dept. 2011). Equitable subrogation is created by the "equities of the situation," *Aetna Cas. & Sur. Co. v. Norwalk Foods, Inc.*, 480 N.Y.S.2d 851, 852 (N.Y. Civ. Ct. 1984), and is used to "promote justice and prevent unjust enrichment." *Hamlet at Willow Creek Dev. Co., LLC v. Ne. Land Dev. Corp.*, 878 N.Y.S.2d 97, 112 (2d Dept. 2009); *Tishman Realty & Constr. Co v. Schmitt*, 330 N.Y.S.2d 174, 177-78 (N.Y. Civ. Ct. 1972). Courts favor the application of equitable subrogation and have extended, rather than restricted, its application. *See 3105 Grand Corp. v. N.Y.C.*, 288 N.Y. 178, 182 (1942); *Brown v. Bellamy*, 566 N.Y.S.2d 703, 704 (3d Dept. 1991). The doctrine broadly encompasses

> every instance in which one party pays a debt for which another is primarily answerable and which in equity and good conscience should have been discharged by the latter, so long as the payment was made either under compulsion or for the protection of some interest of the party making the payment, and in discharge of an existing liability.

Hamlet, 878 N.Y.S.2d at 112.

The subrogee acquires all of the subrogor's rights, defenses and remedies, and can proceed directly against third parties to recoup the amount paid. *See Peerless Ins. Co. v. Michael Beshara, Inc.*, 903 N.Y.S.2d 833, 835 (3d Dept. 2010); *see also Allstate Ins. Co. v. Mazzola*, 175 F.3d 255, 258 (2d Cir. 1999). Once the subrogee has paid the subrogor, he need not delay proceeding with his claims. *See, e.g.*, *Winkelmann v. Excelsior Ins. Co.*, 85 N.Y.2d 577, 584 (1995); *Fasso*, 12 N.Y.3d at 87.

This is consistent with the equitable nature of the right of subrogation. As the Second Circuit previously observed, "it is more in keeping with the intent of Congress that wrongdoers not receive a windfall benefit from the existence of SIPC, and that SIPC be able to recoup its losses from solvent wrongdoers." *Redington I*, 592 F.2d at 624. Equitable subrogation is based on the related concept that the party who causes injury or damage should bear the loss. *See Fasso*, 12 N.Y.3d at 87. Acknowledging SIPC's right to pursue equitable subrogation claims is logically and equitably compelling:

> While a liquidation under [SIPA] is similar to a bankruptcy liquidation, there is a key difference: a bankruptcy trustee has no trust fund to distribute to make creditors whole. Thus, bankruptcy law does not speak to the need, desirability, or authority for repaying that fund through subrogation actions such as the one at issue.

Appleton, 62 F.3d at 800 (declining to accept "*Mishkin*'s rejection of *Redington*'s analogy to insurance law based on [SIPA's] roots in bankruptcy law").

SIPC has advanced approximately $800 million to satisfy claims of BLMIS customers, and is therefore entitled to recover from those legally responsible for the damage. All elements necessary for equitable subrogation are present, and the authorization for SIPC to assert such a claim is recognized in SIPA § 78fff-3(a). Thus, upon advancing funds to pay customers' net equity claims, SIPC acquired all rights, defenses and remedies of the customers, and has standing to proceed directly against the third parties that caused their injuries, including the UniCredit entities. *See Peerless Ins. Co.*, 903 N.Y.S.2d at 835; *Mazzola*, 175 F.3d at 258.

In denying SIPC's subrogation right, the District Court misconstrued the allocation scheme in SIPA as limiting SIPC's subrogation rights. As discussed above, SIPA § 78fff-2(c)(1) dictates the order by which funds are allocated from the estate of customer property. It provides that funds must first be allocated to a customer before SIPC, as subrogee, can receive any recovery from the estate. It does *not* limit or restrict when SIPC can assert a claim for relief against third-party tortfeasors; nor does it limit the claims for relief available to SIPC. A subrogation claim, like a contribution claim or an indemnity claim, may be asserted at any time during the pendency of the underlying action, even though the subrogee may only later recover damages. *See Seguros Banvenez, S.A. v. S/S Oliver Drescher*, 761 F.2d 855, 861 (2d Cir. 1985) (insurer, as subrogee, and its insured could maintain joint action against wrongdoer to recover full amount of loss); *Lumbermans Mut.*

Cas. Co. v. 606 Rest., Inc., 819 N.Y.S.2d 511, 514-15 (1st Dept. 2006) (insurer that failed to intervene in underlying action was collaterally estopped from litigating its subrogation claim); *Omiatek v. Marine Midland Bank*, 781 N.Y.S.2d 389, 389 (4th Dept. 2004) (insurer permitted to intervene to assert equitable subrogation claim in underlying action); *Rink*, 901 N.Y.S.2d at 484 (insurer permitted to intervene in underlying action).

2. SIPA Does Not Preclude SIPC's Standing to Assert Subrogation Claims Against Third-Party Tortfeasors.

The District Court also erred in finding that SIPC can only assert its statutory subrogation claim only against the customer property estate. (SPA-15) First, nowhere does SIPA § 78fff-3(a) limit SIPC's standing as a subrogee to assert claims *against third parties*. Rather, the statutory language is clear and should be construed as written: "SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this chapter. . . ." 15 U.S.C. § 78fff-3(a). The District Court again misconstrued the statutory language—"except that SIPC as subrogee may assert no claim against customer property until after the allocation thereof to customers as provided in section 78fff-2(c) of this title"—as limiting SIPC's right to assert subrogation claims only against the customer property estate, and not against third parties. (SPA-15)

The existence of a statutory allocation scheme in SIPA, however, does not give courts authority "to impose other limitations that are inconsistent with the text

and the statute's purpose and design." *Bilski v. Kappos*, 130 S. Ct. 3218, 3226 (2010); *see also C.I.R. v. Clark*, 489 U.S. 726, 739 (1989) (the exception should be construed narrowly to preserve the primary operation of the general provision); *Estate of Pew v. Cardarelli*, 527 F.3d 25, 31 (2d Cir. 2008) (holding that applying an exception in a statute to all claims would render the exception's terms of limitation meaningless). Here, SIPA § 78fff-3(a) merely limits *when* SIPC can *recover* against the customer property estate and requires only that SIPC await payment of its subrogation rights until the customers' claims have been allocated. *See McKenny v. McGraw (In re Bell & Beckwith)*, 937 F.2d 1104, 1108-09 (6th Cir. 1991). It does not restrict SIPC's rights to bring subrogation claims against third parties.

3. The District Court's Interpretation and Application of *Redington I* to Subrogation Was Erroneous as a Matter of Law.

For the same reasons set forth in Point I, *supra*, the Second Circuit's holding in *Redington I* with respect to SIPC's right of equitable subrogation remains binding precedent in this Circuit. Thus, SIPC's right of equitable subrogation remains good law.

V. The Court Erroneously Dismissed the Trustee's State Law Claim for Contribution Against the Defendants.

The District Court perfunctorily determined that the Trustee cannot assert a state law claim for contribution because: (1) SIPA does not expressly provide for a claim of contribution; and (2) the Trustee is not subject to "liability for damages," as required by the New York contribution statute. (SPA-24-25) Neither of these conclusions is grounded in law and the District Court's decision must be reversed.

A. The Trustee's Claim for Contribution Is Grounded in New York Law.

The Trustee's claim for contribution does not arise out of SIPA, nor is it predicated on violations of SIPA. Rather, the Trustee's claim for contribution is grounded in New York law. In the Amended Complaint, the Trustee alleges that the UniCredit entities engaged in fraud, engaged in conspiracy to commit fraud, aided and abetted BLMIS's breach of fiduciary duty, aided and abetted BLMIS's fraud, and acted in concert with BLMIS in its breach of fiduciary duty. Specifically, the Trustee contends that the UniCredit entities and the other defendants funneled assets to BLMIS, expanded the Ponzi scheme, and deepened BLMIS's insolvency, all of which caused and augmented the injury suffered by the victims of BLMIS's fraudulent activities. (A-184-85, at ¶¶ 561-64) These torts arise under New York law. Logically, the claim for contribution against the UniCredit entities for joint liability arises under New York law as well.

The right of contribution under New York law is an independent claim that arises whenever "two or more persons . . . are subject to liability for damages for the same . . . injury to property . . . ." N.Y. C.P.L.R. 1401 (McKinney 2011). It is this joint liability under New York law that is the core of a right of action for contribution. *See* N.Y. C.P.L.R. 1401; *N.Y. State Elec. & Gas Corp. v. FirstEnergy Corp.*, No. 3:03 Civ. 0438, 2007 WL 1434901, at *8 (N.D.N.Y. May 11, 2007) ("[T]he lynchpin of New York's contribution provision is common liability for the same injury.").

In fact, a claim for contribution is available "whether or not the culpable parties are allegedly liable for the injury under the same or different theories" and "'may be invoked against concurrent, successive, independent, alternative and even intentional tortfeasors.'" *Calcutti v. SBU, Inc.*, 273 F. Supp. 2d 488, 493 (S.D.N.Y. 2003) (citing *Steed Finance LDC v. Laser Advisers, Inc.*, 258 F. Supp. 2d 272, 283 (S.D.N.Y. 2003) (quoting *Raquet v. Braun*, 90 N.Y.2d 177, 182 (1997))). The Trustee has a valid contribution claim against the UniCredit entities and other defendants, as joint tortfeasors, based upon the theory that the UniCredit entities and these defendants acted in concert with Madoff in the Ponzi scheme.

B. A SIPA Trustee Has the Authority to Assert a Claim for Contribution.

The District Court erred in dismissing the Trustee's contribution claim by determining that the Trustee's rights are relegated solely to the specific rights granted by SIPA. (SPA-24-25) The District Court's analysis is wrong.

The Trustee has broad authority under SIPA to bring claims. SIPA § 78fff(b) expressly incorporates portions of title 11 of the Bankruptcy Code. Section 541(a)(1) of the Bankruptcy Code makes clear that the "estate is comprised of all of the following property, wherever located and by whomever held [including] all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1); *see also* 15 U.S.C. § 78fff-1(b); 11 U.S.C. § 323. "[C]hoses in action" and claims the debtor has against others as of the commencement of the case are part of the debtor's property. H.R. No. 95-595, at 367-68 (1977); S. Rep. No. 95-989, at 82-83 (1978); *Air Line Pilots Ass'n, Int'l v. Am. Nat'l Bank & Trust Co. of Chi. (In re Ionosphere Clubs, Inc.)*, 156 B.R. 414, 436-37 (S.D.N.Y. 1993), *aff'd*, 17 F.3d 600 (2d Cir. 1994) ("A debtor's interests in property, including causes of action, are defined by state law, and become assets of the estate once the bankruptcy petition is filed.").

In recovering the property of the estate, the Trustee has the right to assert causes of action. 15 U.S.C. § 78fff-1(b); 11 U.S.C. § 323; *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.9 (1983); *Allard v. Arthur Andersen & Co.*, 924

F.Supp. 488, 495-96 (S.D.N.Y. 1996). These causes of action include a claim for contribution under state law. *See, e.g.*, *Kittay v. Atl. Bank of New York (In re Global Serv. Group LLC)*, 316 B.R. 451, 464 n.13 (Bankr. S.D.N.Y. 2004) (a trustee may assert a contribution claim against defendants jointly liable for the same injuries suffered by a third party); *Westerhoff v. Slind (In re Westerhoff)*, 688 F.2d 62, 64 (8th Cir. 1982) (chapter 11 debtor can assert contribution claim against co-obligor based on installment payments made on joint obligation); *A.P.I., Inc. v. Home Ins. Co.*, 706 F. Supp. 2d 926, 947 (D. Minn. 2010) (estate of bankrupt asbestos manufacturer can assert contribution claims against successor-in-interest to liquidated insurer); *Seitter v. Schoenfeld*, 88 B.R. 343, 350 (D. Kan. 1988) (trustee may assert contribution claim against accountants that reviewed debtor's financial statements); *Kotoshirodo v. Hancock and Kapaa 382 LLC (In re Lull)*, No. 07-90072, 2009 WL 2225450, at *5 (Bankr. D. Haw. July 23, 2009) (trustee of bankruptcy estate of deceased fraudster may assert contribution claim against co-owner of debtor's company and the company itself); *Hill v. Day (In re Today's Destiny, Inc.)*, 388 B.R. 737, 750 (Bankr. S.D. Tex. 2008) (trustee's claim for contribution not subject to *in pari delicto*); *Friedman v. Morabito (In re Morabito)*, No. 94-2542, 1995 WL 502909, at *3 (4th Cir. 1995) (contribution is a core bankruptcy proceeding and can represent a major asset of a bankrupt estate); *SIPC v. Cheshier & Fuller, LLP (In re Sunpoint Sec., Inc.)*, 377 B.R. 513, 570 (Bankr.

E.D. Tex. 2007) (any recovery on state law claims by SIPA trustee, as successor-in-interest to failed brokerage, is reduced by five percent (brokerage's percentage of fault) under Texas's proportionate responsibility statute).

C. New York Law Provides the "Rules of Decision" for State Law Causes of Action.

The District Court's dismissal of the contribution claim is a result of its erroneous conclusion that federal law provides the "rules of decision" for the claim because the Trustee's payment obligations arise out of SIPA. This is incorrect. The Trustee's right to assert a contribution claim under New York law is based on the breach of state law duties, namely the claims of aiding and abetting fraud and aiding and abetting breach of fiduciary duty. (A-178-81, at ¶¶ 547-60) These causes of action arise under New York law, which therefore provides the rules of decision.

No court has held that a SIPA trustee's claims must be rooted in federal law simply because he was appointed under SIPA or because he has SIPA-imposed payment obligations. Cases that involve federal statutes providing a claim for relief are inapposite here; those cases hold only that federal law would supply the "rules of decision" to determine whether a contribution claim was intended by the federal statute at issue in the case. (SPA-24-25) Here, the Trustee does not seek contribution for violations of SIPA or any other federal statute. *See KBL Corp. v. Arnouts*, 646 F. Supp. 2d 335, 341 (S.D.N.Y. 2009) (plaintiff cannot use New York

law to seek contribution under the Copyright Act, which does not permit contribution); *LNC Invs., Inc. v. First Fidelity Bank, Nat'l Ass'n*, 935 F. Supp. 1333, 1349 (S.D.N.Y. 1996) ("It follows that there can be no right of contribution under New York law based on an alleged breach of the [federal statute]."); *Northwest Airlines, Inc. v. Transport Workers Union of America, AFL-CIO*, 451 U.S. 97, 90-101 (1981) (the liability that is the basis for the contribution claim is "entirely a creature of federal statute"); *Lehman Bros., Inc. v. Wu*, 294 F. Supp. 2d 504, 504-05 n.1 (S.D.N.Y. 2003) (contribution in connection with a federal statutory scheme is governed solely by federal law). The contribution claim is based on state law. *See Northwest Airlines*, 451 U.S. at 96-97 & n.38. New York law—not federal law—supplies the "rules of decision."

Nor does the statutory allocation scheme for payment in a SIPA liquidation preclude the Trustee from seeking a claim for contribution. SIPA authorizes the Trustee to bring suits generally, including state law causes of action. *See supra* Points I and II. The common law claims and the claim for contribution are governed neither by SIPA nor the Bankruptcy Code, but rather, by state law. The Supreme Court makes this point clear in *Northwest Airlines*:

> Of course, federal courts, including this Court, have recognized a right to contribution under state law in cases in which state law supplied the appropriate rule of decision.

451 U.S. at 97 n.38.

Judge Michael B. Mukasey's opinion in *LNC Investments* makes this distinction plain. Although it denied the defendant's motion to seek contribution from a third party based on the Trust Indenture Act, a federal statute with no provision permitting contribution, the court *granted* defendant's motion to seek contribution (under N.Y. C.P.L.R. 1401) based on an alleged breach of fiduciary duty. 935 F. Supp. at 1348. Thus, although "there can be no right of contribution under New York law based on an alleged breach of [a federal statute]," a claim for contribution may lie "on the basis of plaintiffs' state law claim of breach of fiduciary duty." *Id* at 1349.

In *In re Today's Destiny*, the court allowed a bankruptcy trustee's contribution claim in a similar context. 388 B.R. at 751. Purchasers of equipment whom the debtor had defrauded filed proofs of claim. *See id.* at 750. The bankruptcy trustee sued the lenders who financed the equipment sales and leases for aiding and abetting the fraud, and sought contribution from the lenders for the debtor's liability. *See id.* at 750-51. The district court held that the trustee had stated a valid claim for contribution under state law even though the debtor's liability had not yet been determined. *See id.* at 754-55.

D. The Trustee Has Sufficiently Pleaded a Claim for Contribution Under New York Law.

The Trustee may seek contribution from the UniCredit entities as joint tortfeasors under New York law. N.Y. C.P.L.R. 1401, 1403 (McKinney 2011). The Trustee will pay proportionately thousands of allowed customer claims seeking to recover billions of dollars invested with BLMIS and diverted by Madoff. The Unicredit entities are liable for a commensurate portion of those claims as joint tortfeasors. This action, in part, seeks a determination of the UniCredit entities' joint liability for the injury to customer property.[14]

1. A Customer Claim Constitutes an "Adverse Judgment."

The District Court, absent any discussion of case law, determined that although the Trustee is obligated to pay customer claims pursuant to SIPA, the Trustee "is not subject to 'liability for damages' in the sense contemplated by New York's contribution statute." (SPA-25) The District Court's reasoning here was unclear. As set forth above, joint liability under New York law is the lynchpin to a right of action for contribution. *See* N.Y. C.P.L.R. 1401. The Trustee has already alleged the UniCredit entities' complicity—conduct that resulted in injury to customer property. New York law requires only the existence of either an adverse

[14] New York law allows the Trustee to assert the claim for contribution in the underlying action. *See Klinger v. Dudley*, 41 N.Y.2d 362, 369 (1977) ("[A] main defendant may assert his claim for contribution prior to the payment of any amount to the plaintiff.").

judgment or other compulsion to pay. *See, e.g.*, *FirstEnergy*, 2007 WL 1434901, at *7 (N.D.N.Y. May 11, 2007). Each of the thousands of customer claims filed in the liquidation proceeding compels the Trustee to pay. Courts have held that an order establishing liability satisfies this adverse judgment requirement. *See*, *e.g.*, *In re Today's Destiny*, 388 B.R. at 754-55 (in a proceeding to resolve a contested proof of claim, a trustee need not show another compulsion to pay in order to assert a contribution claim); *FirstEnergy*, 2007 WL 1434901, at *7 (finding that agency orders "can represent the satisfaction of a tort-like liability. . . ."). Further, where, as here, many customer claims have been paid by the Trustee with moneys advanced by SIPC, the compulsion requirement is satisfied. *See Relyea v. State*, 399 N.Y.S.2d 710, 711 (3d Dept. 1977) (right of contribution accrues on the date upon which payment is made by the party seeking contribution).

2. The Trustee Sufficiently Alleges a Claim for Contribution.

The Trustee has alleged sufficient facts that, if accepted as true, "state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). "When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief." *Id.* at 1950.

The Trustee's allegations about the UniCredit entities are sufficient to state a claim for relief. The Trustee alleges that the UniCredit entities committed intentional torts. The UniCredit entities, along with other defendants, supplied billions of dollars to perpetuate the Ponzi scheme, greatly increasing the damage done, and the customer claims that the Trustee must satisfy on behalf of BLMIS. This more than adequately sets forth a claim for contribution. *See, e.g.*, *Contino v. Lucille Roberts Health Spa*, 509 N.Y.S.2d 369, 370 (2d Dept. 1986); *Raquet*, 90 N.Y.2d at 183; *FirstEnergy*, 2007 WL 1434901, at *5. On a motion to dismiss, it is enough that the Trustee has adequately alleged that the UniCredit entities have tort liability. *See LNC Inv.,* 935 F. Supp. at 1349. It was therefore error for the District Court to dismiss the Trustee's claim.

CONCLUSION

For the foregoing reasons, the Trustee respectfully requests that this Court reverse in its entirety the District Court's Rule 54(b) Judgment, embodying the July 28 Order, and remand the matter for further proceedings.

Date: New York, New York
February 16, 2012

Respectfully submitted,

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This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 15,293 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Office Word 2010 in 14-point Times New Roman font.

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Respectfully submitted,

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