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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES INVESTOR PROTECTION CORPORATION, Plaintiff, v. BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Defendant.	Adv. Pro. No. 08-01789 (BRL) SIPA LIQUIDATION (Substantively Consolidated)
In re: BERNARD L. MADOFF, Debtor.	
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. DOUGLAS HALL; STEVEN HEIMOFF; BOTTLEBRUSH INVESTMENTS, L.P.; LEGHORN INVESTMENTS LTD.; and KAMALA D. HARRIS, solely in her capacity as Attorney General for the State of California, Defendants.	Adv. Pro. No. _____

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

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OTHER AUTHORITIES

Irving H. Picard, as trustee (the "Trustee") for the substantively consolidated liquidation of the business of Bernard L. Madoff Investment Securities LLC ("BLMIS") under the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa *et seq.* ("SIPA") and the estate of Bernard L. Madoff, individually ("Madoff"), by and through his undersigned counsel, respectfully submits this memorandum of law in support of his application ("Application") pursuant to sections 362(a) and 105(a) of the United States Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.* (the "Bankruptcy Code"), and SIPA §§ 78eee(a)(3) and 78eee(b)(2)(B) to: (i) enforce the December 15, 2008 stay order and related orders (the "Stay Orders") of the United States District Court for the Southern District of New York (the "District Court") and the automatic stay in this proceeding; (ii) declare that the competing actions brought by certain third party plaintiffs whose names appear in the caption above as defendants herein (the "Third Party Plaintiffs") against certain of the defendants named in the Trustee's action against the Estate of Stanley Chais ("Chais")[1] and related entities and individuals, *Picard v. Chais*, Adv. Pro. No. 09-01172 (Bankr. S.D.N.Y., filed May 1, 2009) (the "Trustee's Chais Action" and all of the defendants named in the Trustee's Chais Action, the "Chais Defendants")[2] in various jurisdictions (collectively, the "Third Party Actions") violate the Stay Orders and the automatic stay and are void *ab initio* as against the Chais Defendants; and (iii) preliminarily enjoin the Third Party Plaintiffs from

[1] Stanley Chais passed away in 2010. On October 19, 2010, his counsel filed a notification of his death with the court. (Suggestion of Death, *Picard v. Chais*, Adv. Pro. No. 09-01172 (Bankr. S.D.N.Y. May 1, 2009), ECF No. 85.) On January 3, 2011, the Estate of Stanley Chais and its executor, Pamela Chais, were substituted for Stanley Chais as a defendant in this action. (*Id*. ECF No. 88.)

[2] The Chais Defendants are identified in the caption to the complaint in the Trustee's Chais Action. (*See* Declaration Of Tracy L. Cole in In Support Of The Trustee's Application For Enforcement Of Automatic Stay And Preliminary Injunction (the "Cole Declaration"), Ex. A.)

litigating the Third Party Actions or any other actions as against any of the Chais Defendants, pending the completion of the Trustee's Chais Action.[3]

PRELIMINARY STATEMENT

In connection with his efforts to collect billions of dollars of stolen customer property, the Trustee filed his complaint on May 1, 2009 against the Chais Defendants, who collectively received more than $1 billion in transfers of "customer property."[4] The Trustee's efforts to recoup that customer property are being hampered by the Third Party Actions, which are proceeding apace in California state court, and which, if successful, would leave nothing for the thousands of customers defrauded by Madoff and his cohorts.

Stanley Chais was, along with Jeffry Picower, Carl Shapiro, and Norman Levy, one of the core group of longstanding individual customers of BLMIS, with a relationship with Madoff extending back to the 1970s. Chais managed "feeder funds" in the form of limited partnerships that were created for the purpose of investing in BLMIS (the "Chais Funds"). Through the Chais Funds and BLMIS accounts held by Chais, his family and related entities and trusts, Chais withdrew more than $1.3 billion from BLMIS, more than $1 billion of which consisted of fictitious profits, *i.e.*, other people's money. As the Trustee will prove in his action against the Chais Defendants, the Chais Funds were virtually entirely invested in BLMIS, and virtually all of their assets consist of hundreds of millions of dollars of other customers' money withdrawn from BLMIS—there is no other money. As to all Chais Defendants, information available to the

[3] The Trustee's investigation is continuing, and he reserves the right to seek injunctive and other relief with respect to other defendants named in the Third Party Actions.

[4] Under section 78*lll*(4) of SIPA, "customer property" is defined as "cash and securities . . . at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted."

Trustee shows that their collective assets will be insufficient to satisfy the Trustee's claims. (Cole Decl. ¶ 6.)

There are currently five Third Party Actions[5] pending against various of the Chais Defendants, which are the subject of this Application.[6] Each of these actions asserts claims belonging to the Trustee. And even as to those Third Party Plaintiffs' causes of action that may not belong to the Trustee, each of the Third Party Actions violates the automatic stay because they each seek recovery of the same funds sought by the Trustee, based on the same operative facts and against the same defendants as the Trustee's Chais Action. They therefore seek to control or interfere with property of the estate, or to collect on claims against the debtor, in violation of section 362(a). Moreover, the Third Party Actions are so closely related to the Trustee's claims that to permit the Third Party Actions to proceed to a judgment would threaten to deplete potential estate assets, interfere with the administration of the estate, upend SIPA's equitable distribution scheme, derail the bankruptcy proceeding and create a race to the courthouse.

While the Third Party Actions had been formally or informally stayed pending rulings by the California Superior Court, that court has indicated an inclination to allow at least some claims to move forward absent a contrary direction from this Court or a motion before it by the

[5] The Third Party Actions are: *Hall v. Chais*, Case No. BC413820 (Ca. Super. Ct. filed May 13, 2009); *Heimoff v. Chais*, Case No. BC413821 (Ca. Super. Ct. filed May 13, 2009); *Bottlebrush Investments L.P. v. The Lambeth Company*, Case No. BC407967 (Ca. Super. Ct. filed Feb. 13, 2009); *Leghorn Investments LTD v. Brighton Investments*, Case No. BC408661 (Ca. Super. Ct. filed Feb. 27, 2009); and *People of the State of California v. Pamela Chais, et al.*, Case No. BC422257 (Ca. Super. Ct. filed Sept. 22, 2009). Certain of the Third Party Actions are consolidated and all are related. *See* Cole Decl. Ex. B. For the Court's reference, documents relating to the Third Party Actions are attached as Exhibits A through N to the Cole Declaration.

[6] Another third-party action, *Helen Epstein Living Trust v. Crescent Securities, et al.*, Case No. BC409658 (Ca. Super. Ct. filed Mar. 13, 2009), had originally named as defendants certain of the Chais Defendants. The *Epstein* Plaintiffs' claims against the Chais Defendants were subsequently dismissed. The Trustee reserves the right to seek injunctive relief and any other appropriate remedy should the *Epstein* Plaintiffs take any future action against the Chais Defendants.

Trustee. (See Cole Decl. Ex. P.) Crucially, the California Superior Court has indicated that it will make a determination as to these claims imminently, unless an order is entered by this Court. Accordingly, the Trustee seeks to enforce the automatic stay and Stay Orders, and to otherwise potentially enjoin the Third Party Plaintiffs from proceeding.

STATEMENT OF FACTS

The facts and procedural history relevant to the Madoff Ponzi scheme have been set forth numerous times and need not be repeated here.[7]

A. The SIPA Trustee's Authority

Under SIPA, the Trustee is charged with recovering and distributing customer property to BLMIS's customers, assessing claims and liquidating any other assets of the firm for the benefit of the estate and its creditors. Pursuant to section 78fff-1(a) of SIPA, the Trustee has the general powers of a bankruptcy trustee in addition to the powers granted by SIPA.[8]

The Trustee has thus far recovered or entered into agreements to recover more than $8.7 billion for victims of the Madoff Ponzi scheme. (Trustee's Sixth Interim Report ¶ 16, *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec.*, Adv. Pro. No. 08-01789 (Bankr. S.D.N.Y. filed Nov. 15, 2011), ECF No. 4529.) The Trustee's recovery process involves identifying those individuals and entities who received avoidable transfers from BLMIS and recovering these moneys for *pro rata* distribution to customers in accordance with SIPA.

[7] *See Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Bernard L. Madoff Inv. Sec. LLC)*, 424 B.R. 122, 125-33 (Bankr. S.D.N.Y. 2010), *aff'd* 654 F.3d 229 (2d Cir. 2011); *Picard v. Fox*, 429 B.R. 423, 426 (Bankr. S.D.N.Y. 2010).

[8] Further, pursuant to section 78fff(b) of SIPA, chapters 1, 3, 5 and subchapters I and II of Chapter 7 of the Bankruptcy Code are applicable to this case.

B. The Court-Ordered Claims Administration Process[9]

The Trustee sought and obtained an order from this Court to implement a customer claims process in accordance with SIPA (the "Claims Procedures Order"), which required, *inter alia*, that certain notice be given.[10] More than 16,000 potential customer, general creditor and broker-dealer claimants were included in the mailing of the notice. The Trustee published the notice in all editions of *The New York Times*, *The Wall Street Journal*, *The Financial Times*, *USA Today*, *Jerusalem Post*, and *Ye-diot Achronot* and posted claim forms and claims filing information on the Trustee's website ("Trustee Website"), and SIPC's website.

Under the Claims Procedures Order, claimants were directed to mail their claims to the Trustee. All customers and creditors were notified of the mandatory statutory bar date for filing of claims under section 78fff-2(a)(3) of SIPA, which was July 2, 2009 (the "Bar Date"). The Trustee also provided several reminder notices.[11] By the Bar Date, the Trustee had received 16,239 customer claims. In accordance with the Claims Procedures Order, the Trustee has developed a comprehensive claims administration process for the intake, reconciliation, and resolution of these customer claims.

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[9] The facts in this section are drawn from the Trustee's Third Interim Report. (Trustee's Amended Third Interim Report, *Sec. Investor Prot. Corp.*, Adv. Pro. No. 08-01789, ECF No. 2207.)

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

[11] On May 21, 2009, the Trustee mailed a reminder notice to customers who had not yet filed a claim that the statutory bar date was July 2, 2009. On June 22, 2009, the Trustee mailed a final bar date reminder notice (the "Final Reminder Notice") to 7,766 known past and present customers of BLMIS from whom a claim had not yet been received. In addition, the Trustee posted the Final Reminder Notice on the Trustee Website.

C. The Net Equity Decision

The statutory framework for the satisfaction of customer claims in a SIPA liquidation proceeding provides that customers share *pro rata* in customer property to the extent of their net equity, as defined in section 78*lll*(11) of SIPA. The Securities Investor Protection Corporation ("SIPC") advances funds to the trustee for a customer with a valid net equity claim, up to the amount of their net equity, if their ratable share of customer property is insufficient to make them whole. Such advances are capped at $500,000 per customer.

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

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

Id. at 135.

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

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

> profiting from the principal investments of Net Losers, yielding an inequitable result.
>
> *** * ***
>
> Equality is achieved in this case by employing the Trustee's method, which looks solely to deposits and withdrawals that in reality occurred.

Id. at 141-42.

On March 8, 2010, the Bankruptcy Court issued an order approving the Trustee's Net Equity calculation ("Net Equity Order") and certified an appeal of the Net Equity Order directly to the United States Court for the Second Circuit Court of Appeals. (Net Equity Order, *Sec. Investor Prot. Corp.*, Adv. Pro. No. 08-01789, ECF No. 2020; Certification of Net Equity Order, *Id.*, ECF No. 2022.) On August 16, 2011, the Second Circuit affirmed the Net Equity Decision. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229 (2d Cir. 2011). The Circuit found that

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

In re Bernard L. Madoff, 654 F.3d at 238.

D. The Trustee's Proceeding Against the Chais Defendants

On May 1, 2009, the Trustee commenced an action against the Chais Defendants, *Picard v. Chais*, Adv. Pro. No. 09-01172 (Bankr. S.D.N.Y.). In his complaint (the "Trustee's Complaint" or the "Tr. Compl."), the Trustee seeks the return of more than $1.3 billion under SIPA §§ 78fff(b) and 78fff-2(c)(3), sections 105(a), 542, 544, 547, 548(a) and 551 of the

Bankruptcy Code, N.Y. Debt. & Cred. § 270 *et seq*., and other applicable law, for turnover,[12] accounting, preferences, fraudulent conveyances, damages, and objection to claim in connection with certain transfers of property by BLMIS to or for the benefit of the defendants. By his action, the Trustee seeks to set aside the transfers to the Chais Defendants and preserve the property for the benefit of the defrauded customers of BLMIS. (Cole Decl. Ex. A (Tr. Compl.) ¶ 4) (*Id.* ECF No. 1.)

In his complaint, the Trustee alleges that Chais was a beneficiary of the BLMIS Ponzi scheme for at least thirty years. (Tr. Compl. ¶ 2.) The Trustee alleges that Chais began investing with BLMIS in the 1970s and that the Chais Defendants have collectively profited from the Ponzi scheme by withdrawing more than $1 billion in fictitious profits, or other customers' money. (Tr. Compl. ¶¶ 2, 99.) Among the named defendants are three limited partnerships, the Brighton Company ("Brighton"), the Lambeth Company ("Lambeth"), and the Popham Company ("Popham") (collectively, as defined above, the "Chais Funds") for which Chais acted as general partner and which were investment funds that purportedly engaged in "arbitrage transactions." (Tr. Compl. ¶¶ 42-45.) The Trustee alleges that Chais dominated the Chais Funds, which functioned as his alter egos, and used them merely as an instrument to advance his personal interests. (*Id.* ¶ 45.) The Trustee further alleges that, as general partner of the Chais Funds, Chais is personally responsible for all preferential and fraudulent transfers made from BLMIS to the Chais Funds. (*Id.*)

The Chais Funds had no purpose other than to invest in BLMIS, and were all or substantially all invested in BLMIS from their formation until the Ponzi scheme was exposed. (Cole Decl. ¶ 5.) During the period in which they were invested in BLMIS, virtually every cent

[12] The turnover count in the Trustee's Complaint was dismissed. (Adv. Pro. No. 09-01172, ECF No. 90 (February 24, 2011).)

invested directly or indirectly in the Chais Funds was routed to BLMIS, and virtually every cent distributed by the Chais Funds to their limited partners derived from BLMIS.

Also named as defendants in the Trustee's Chais Action are certain of Chais's family members, and various entities, including a large number of trusts (the "Chais Trusts"), which had accounts with BLMIS (collectively, the "Chais Family Accounts"). The Trustee alleges that the Chais Family Accounts, like the Chais Funds, have been dominated and used merely as an instrument of Chais to benefit the interests of Chais and those of his family. (Tr. Compl. ¶ 92; *id.* Ex. A.)

The Trustee alleges that the Chais Defendants knew or should have known that they were benefitting from manipulated returns and that BLMIS was engaged in fraud based on a number of indicia of fraud, including impossible transactions and the patterns of returns in various accounts. (*Id.* ¶¶ 2, 3, 98, 101, 103, 104.) Among other things, BLMIS reported implausibly consistent, and consistently high, rates of return for the Chais Fund accounts—during the 12-year period from 1996 to 2007, the purported rate of return remained between 20% and 24% for each account for each year in which trading activity took place over the entire year. (*Id.* ¶ 103.) Yet at the same time, BLMIS reported fantastical and wildly varying rates of return for the Chais Family Accounts. (*Id.*) It was not plausible that a single investment firm could simultaneously achieve such different results, results which permitted the Chais Defendants to collectively withdraw more than $1 billion in fictitious profits from BLMIS. (*Id.*)

The Trustee has alleged that BLMIS used the funds deposited from investors or new investments to, among other things, pay redemptions to or on behalf of other investors and to make other transfers, and that the Chais Defendants were among the primary beneficiaries of this scheme. (*Id.* ¶ 26-27.) The Trustee extensively outlined the transfers from BLMIS to each of the

relevant Chais Defendants' accounts in Exhibit B to his complaint and has alleged that the transfers are subject to recovery by the Trustee. (*Id.* ¶¶ 106-110, Ex. B.) The Trustee's Complaint alleges that the source of funds in many of the Chais Family Accounts were fictitious profits received by Chais for his participation in the Ponzi scheme. (*Id.* ¶ 102.) The Trustee has further alleged that Chais collected management fees of 25% of each Chais Fund's entire net profit for every calendar year in which profits exceeded 10% (which occurred since at least 1996). (*Id.* ¶ 99.) Based on the Trustee's investigation to date, Chais took these management fees out of "profits" withdrawn from BLMIS accounts before those "profits" were distributed to the relevant Fund or investor. (Cole Decl. ¶ 8.)

Certain of the Chais-related entities filed motions to dismiss the Trustee's complaint. (Adv. Pro. No. 09-01172, ECF Nos. 11, 36, 40.) Stanley and Pamela Chais, and certain entities they control, answered the Trustee's complaint and filed counterclaims against the Trustee in connection with a letter that the Trustee wrote to Goldman Sachs in 2009 directing Goldman Sachs to cease moving any funds in an account held by Stanley and Pamela Chais.[13] (*Id.* ECF No. 45.) The Trustee moved to dismiss the counterclaims and opposed the motions to dismiss. (*Id.* ECF Nos. 62-69.) A hearing on these motions was held on May 5, 2010. On November 30, 2010, this Court dismissed Stanley and Pamela Chais' counterclaims against the Trustee. (*Id.* ECF No. 86.) On November 30, 2010, this Court denied one of the Chais-related motions to dismiss (*id.* ECF No. 87); another such motion was resolved by stipulation on January 13, 2011 (*id.* ECF No. 89). On February 24, 2011, the court issued a written decision dismissing the Trustee's turnover claim but otherwise denying the final remaining Chais-related motion to

[13] The Chais Defendants and the Trustee have entered into a stipulation which freezes the assets of the Chais Defendants at Goldman Sachs. (Cole Decl. Ex. C.)

dismiss. (*Id.* ECF No. 90.) On April 15, 2011, various Chais-related entities filed answers. (*Id.* ECF Nos. 95-116.)

* * * * *

Based on the Trustee's investigation to date, substantially all assets currently held by the Chais Funds and the Chais Trusts are ultimately derived from BLMIS.[14] (Cole Decl. ¶ 5.) Furthermore, the Chais Funds were all or substantially all invested in BLMIS during the relevant period. (*Id.*) Crucially, the evidence available to the Trustee indicates that the assets currently held by the Chais Defendants are insufficient to satisfy the Trustee's avoidance claims. (*Id.* ¶ 6.) Further, if the Third Party Plaintiffs were to recover any money from the Chais Defendants by way of their actions, the Trustee would bring avoidance actions against them as subsequent transferees of avoidable transfers.

E. The Third Party Actions Seek Customer Property From The Chais Defendants

There are currently five Third Party Actions known to the Trustee to be pending against the Chais Defendants that seek customer property in the guise of damages and that are at issue in this Application. At this time, the Trustee seeks an injunction only as to the Chais Defendants, not other defendants named in the Third Party Actions. As detailed below, the Third Party Plaintiffs are limited partners in the Chais Funds or in sub-entities that were limited partners in the Chais Funds. Per the Third Party Plaintiffs' own allegations, and as described further herein, the Chais Funds and sub-entities had no purpose other than to invest directly or indirectly in BLMIS. As such, each of the Third Party Actions seeks to recover funds that the Chais

[14] Chais appears to have had certain assets other than his interests in accounts at BLMIS or funds related to BLMIS, including interests in certain real estate. However, the Trustee believes that Chais's interests in these investments were purchased or otherwise procured with funds transferred from BLMIS. (Cole Decl. ¶ 7.) To the extent Chais and other family members may have had other sources of income, these amounts are dwarfed by—and, based on the Trustee's investigation, insufficient to satisfy—the Trustee's claims against the Chais Defendants. (*Id.* ¶ 6.)

Defendants allegedly received in connection with the BLMIS fraud. Each of the Third Party Actions is based on the same facts alleged in the Trustee's Complaint, although they all further allege misrepresentations or other conduct by the Chais Defendants directed specifically toward the Third Party Plaintiffs. Notably, the Chais Funds collectively withdrew approximately $775 million more from BLMIS than they deposited, so any recovery in these Third Party Actions would consist of other investors' money. (Cole Decl. ¶ 10.)

1. Allegations and Procedural History

a. *Hall v. Chais,* Case No. BC413820 (Ca. Super. Ct.)
Heimoff v. Chais, Case No. BC413821 (Ca. Super. Ct.)

Douglas Hall ("Hall") and Steven Heimoff ("Heimoff") have brought claims based on the Chais Funds' investment in BLMIS. On or about May 13, 2009, Hall commenced a derivative action in the Superior Court of California (the "California Superior Court") against Chais, Lambeth, Francis X. Mantovani ("Mantovani"), Halpern & Mantovani ("H&M") and Does 1-20 (the "*Hall* Action"). (Cole Decl. Ex. D.) Crescent Securities ("Crescent"), a sub-entity that invested into Chais Fund Lambeth, was named as a nominal defendant. (*Id.*) The complaint was amended on December 18, 2009, after the Trustee's Complaint was filed, to add as defendants additional defendants named in the Trustee's Complaint, and to designate Lambeth as a nominal defendant only. (*Id.*) The complaint was further amended on or about June 18, 2010 and Albert Angel ("Angel") was removed as a defendant. (*Id.*)

On or about May 13, 2009, Heimoff (collectively with Hall, the "*Hall* Plaintiffs")[15] commenced a derivative action in the California Superior Court against Chais, Popham, Mantovani, H&M, Does 1-20, and nominal defendant Marloma Securities ("Marloma"), a sub-entity that invested in Chais Fund Popham (the "*Heimoff* Action"). (Cole Decl. Ex. E.) As with

[15] Hall and Heimoff are both represented by the same counsel in these actions.

the *Hall* Action, the complaint in the *Heimoff* Action was amended on December 18, 2009 to add as defendants additional defendants named in the Trustee's Complaint, and to designate Popham as a nominal defendant only. (*Id.*) The complaint was further amended on or about June 18, 2010 and Angel was removed as a defendant. (*Id.*) On or about August 6, 2010, the *Hall* and *Heimoff* Actions were consolidated. (*Id.* Ex. B.)

The *Hall* Plaintiffs filed a Third Amended Complaint on January 13, 2011 (the "*Hall* Complaint"), and now name the Chais Defendants (except Brighton), Mantovani, H&M, Does 1-100 and nominal defendants Popham, Marloma, Lambeth and Crescent. (Cole Decl. Ex. F.) Per the Third Amended Complaint, Hall is the son of Vivian H. Hall ("Vivian Hall") and co-trustee of the Vivian H. Hall IRA (the "Hall IRA"). (*Id.* ¶ 1.) Vivian Hall, and, upon her death, her estate, was a limited partner in Crescent, a purported limited partnership that allegedly was invested wholly in Lambeth and that was formed solely for the purpose of investing in Lambeth. (*Id.* ¶¶ 1, 13-14.) Theodor Halpern ("Halpern") served as Crescent's general partner from its formation until his retirement in 2004, after which Mantovani assumed the role of general partner. (*Id.* ¶¶ 13, 16.) The Third Amended Complaint further alleges that from 1978 until the exposure of the Ponzi scheme, Vivian Hall and the Hall IRA invested funds with Crescent. (*Id.* ¶ 15.) Hall brings the action directly in his capacity as a co-trustee of the Hall IRA and as a limited partner of Crescent, and also derivatively on behalf of Crescent and Lambeth. (*Id.* ¶¶ 7-8.)

Per the Third Amended Complaint, Heimoff was a limited partner in Marloma Securities, a purported limited partnership that was invested wholly in Chais Fund Popham and that was formed solely for the purpose of investing in Popham. (*Id.* ¶¶ 2, 16-17.) As with Crescent, Halpern served as Marloma's general partner from its formation until his retirement in 2004,

after which Mantovani assumed the role of general partner. (*Id.* ¶¶ 13, 16.) The Third Amended Complaint further alleges that from 1991 until the exposure of the Ponzi scheme, Heimoff invested funds with Marloma. (*Id.* ¶ 18.) Heimoff brings the action directly in his capacity as a co-trustee of the Steven Heimoff IRA and as a limited partner of Marloma, and also derivatively on behalf of Marloma and Popham. (*Id.* ¶¶ 7-8.) As with Crescent, Halpern served as Marloma's general partner from its formation until his retirement in 2004, after which Mantovani assumed the role of general partner. (*Id.* ¶¶ 13, 16.)

As against the Chais Defendants, the *Hall* Complaint asserts claims for grossly negligent, willful and/or reckless breach of fiduciary duty (count 2), aiding and abetting breaches of fiduciary duty (count 3), unjust enrichment and constructive trust (count 5), breach of contract (count 7), fraud (count 9), and fraudulent conveyance (count 10). (*Id.* at 31-40.) As against the Chais Defendants, the *Hall* Complaint seek a judgment awarding damages, punitive damages, a constructive trust and restitution, set-aside of fraudulent conveyances, and a constructive trust over all fraudulently transferred assets. (*Id.* at 40-41.)

The *Hall* Plaintiffs' own allegations make clear that the funds they seek to recover consist of BLMIS customer property, and the unjust enrichment and constructive trust claims seek funds that were fraudulently transferred from BLMIS. The *Hall* Plaintiffs seek, among other things, reimbursement for their investment in BLMIS. (*See, e.g., id.* ¶ 21 ("Unbeknownst to the Sub-Partners [Hall and Heimoff], the Partnerships [Lambeth and Popham], in turn, invested all of their capital with B[L]MIS. Accordingly, Plaintiffs believe that all of the Sub-Partnerships' [Crescent and Marloma] assets have been lost."); *see also* ¶¶ 12, 20, 97, 100, 105, 108, 113, 118, 123, 144, 194, 195(c), 202.) The *Hall* Plaintiffs' allegations also make clear that certain management fees they seek to recover consist of customer property transferred from BLMIS to

the Chais Defendants. (*See, e.g., id.* ¶ 24 (Chais' management fees "consisted of fees subtracted from the purported profits of the Partnerships' limited partners such as the Sub-Partnerships"); *id.* ¶ 25 ("Chais distributed part or all of the [management fees] to Chais-related Individuals and Chais Entities."); *see also id.* ¶¶ 94-96, 103, 125, 153(c), 158(c), 166, 171, 185(c), 190(c).) This is the same property that was fraudulently transferred to the Chais Defendants from BLMIS, and that the Trustee seeks to recover in the Trustee's Chais Action, property that should be returned to the estate for equitable distribution to BLMIS creditors under the distribution scheme established by SIPA.

b. *Bottlebrush Investments LP v. The Lambeth Company*, Case No. BC407967 (Ca. Super. Ct.)
***Leghorn Investments LTD v. Brighton Investments*, Case No. BC408661 (Ca. Super. Ct.)**

On or about February 13, 2009, Bottlebrush Investments, L.P. ("Bottlebrush"), commenced an action in the California Superior Court against Chais, Lambeth, and Does 1-100. (Cole Decl. Ex. G.) On or about February 27, 2009, Leghorn Investments, Ltd ("Leghorn", collectively with Bottlebrush, the "*Bottlebrush* Plaintiffs"), commenced an action in the California Superior Court against Brighton Investments,[16] Chais, and Does 1-100. (*Id.* Ex. H.)[17] The complaints were subsequently amended twice.[18] On or about August 6, 2010, the actions were consolidated (as consolidated, the "*Bottlebrush* Action") and the plaintiffs filed a consolidated third amended complaint. (Cole Decl. Exs. B, I.) On or about January 13, 2011, Bottlebrush and Leghorn filed a Fourth Amended Complaint (the "*Bottlebrush* Complaint"),

[16] Plaintiff appears to be referring to Brighton.

[17] Bottlebrush and Leghorn are both represented by the same counsel in these actions.

[18] The complaints filed by Bottlebrush and Leghorn were each first amended on May 5, 2009 and were second amended on November 19, 2009. (Cole Decl. Exs. G and H.) The Bottlebrush and Leghorn second amended complaints restate the claims as derivative claims on behalf of Lambeth and Brighton, respectively. (*Id.*) For purposes of this Application, references to the Bottlebrush *Plaintiffs* concern the plaintiffs in their derivative capacities on behalf of the funds they purport to represent.

which names the Chais Defendants (except Popham), Does 1-250 and nominal defendants Lambeth and Brighton. (Cole Decl. Ex. I (Fourth Amended Complaint).) Brighton filed a cross-complaint against Leghorn and Lambeth filed a cross-complaint against Bottlebrush.

Bottlebrush is purportedly a limited partnership that was formed for the purpose of serving as a limited partner of Lambeth. (Cole Decl. Ex. I (Fourth Amended Complaint) ¶ 1.) Similarly, Leghorn was a limited partnership that was formed purportedly for the purpose of serving as a limited partner of Brighton. (*Id.*)

The *Bottlebrush* Plaintiffs currently assert claims for breach of fiduciary duty (count 1), negligence (count 2), breach of contract (count 3), fraud (count 4), unjust enrichment (count 5), and fraudulent conveyance (count 6). (Cole Decl. Ex. I (Fourth Amended Complaint) at 19-27.) The plaintiffs seek a judgment, *inter alia*, awarding damages, setting aside conveyances from Chais's personal estate to the Chais Trusts, and imposing a constructive trust on all fraudulently transferred assets. (*Id.* at 27.)

As discussed below, the *Bottlebrush* Plaintiffs have amended their complaint to omit factual allegations that demonstrated that their claims were nothing more than fraudulent transfer claims belonging to the Trustee. Even from the face of their current complaint, however, the *Bottlebrush* Plaintiffs plainly assert fraudulent conveyance claims and seek to recover BLMIS customer property. The Plaintiffs seek recovery of the funds known to have been wholly invested into BLMIS through the Chais Funds. (*See, e.g., id.* ¶ 73 ("Chais . . . breached his duty of care by negligently funneling of [sic] the entirety of the partnerships' [Lambeth and Brighton] capital to BLMIS. As a result, all or substantially all of the partnerships' capital investment was lost in Madoff's Ponzi scheme."); *see also* ¶¶ 63, 68(b)-(d), 83-84, 95.) The management fees sought by the *Bottlebrush* Plaintiffs also explicitly consist of customer property that was

withdrawn from BLMIS by Chais and his family. (*See, e.g., id.* ¶ 62 ("Chais led these investors to believe that he was actively managing their investments and extracted fees equal to 25% of annual profits for his services."); *see also* ¶¶ 63, 68(a)-(b), 76, 89.) The Trustee's Chais Action seeks return of the same customer property that was fraudulently transferred to the Chais Defendants from BLMIS, in order to make equitable distribution of this customer property to BLMIS creditors under the distribution scheme established by SIPA.

c. *People of the State of California v. Pamela Chais, et al.*, Case No. BC422257 (Ca. Super. Ct.)

On or about September 22, 2009, Kamala D. Harris, solely in her capacity as the California Attorney General ("CAAG"), commenced an action against Pamela Chais, as personal representative and executor of the estate of Stanley Chais (as defined above, "Chais"), and Does 1 through 100, inclusive, on behalf of investors in the Chais Funds, in the California Superior Court (the "CAAG Action"). (Cole Decl. Ex. J.) The complaint in the CAAG Action was amended on September 9, 2011 (as amended, the "CAAG Complaint"). (*Id.*) The CAAG seeks restitution, disgorgement and civil penalties on behalf of the Chais Funds' investors, and costs. (*Id.* at 15–16.) The CAAG also seeks an injunction prohibiting Chais from engaging in the conduct alleged in the CAAG Complaint to violate California state securities and business law. (*Id.*)[19] On October 27, 2011, Chais filed an answer to the CAAG Complaint.

The CAAG seeks "disgorge[ment of] all profits and compensation" and "full restitution" of money and property acquired by Chais by means of the complained-of acts. (*Id.* at 15.) Per the CAAG Complaint, compensation earned by Chais in the form of fees totaled approximately $270 million. (*Id.* ¶ 36.) By seeking disgorgement of the fees received by Chais, the CAAG

[19] The Trustee does not seek to enjoin the CAAG from pursuing or obtaining this injunctive and regulatory relief, which does not infringe on the Trustee's ability to recover and distribute customer property.

seeks funds that allegedly were transferred by BLMIS to Chais and the Chais Funds—the very same funds that the Trustee seeks to recover in his Action for the benefit of all BLMIS customers and other creditors. In addition, although the CAAG Complaint does not specify the amount of restitution sought, based the Trustee's investigation, a reasonable estimate of the Chais Funds' *principal* investments is over $219 million. (Cole Decl. ¶ 9.) Thus, it appears that the CAAG seeks at least $489 million (the sum of $270 million and $219 million) in disgorgement of fees and restitution of principal investment alone, in addition to costs. Importantly, the recovery of these amounts by the CAAG, without more, would exhaust all of the Chais Defendants' assets.

Just as the Trustee sets forth in his Complaint, the CAAG alleges that Chais knew or should have known of the Ponzi scheme. (Cole Decl. Ex. J ¶¶ 33–35.) Notably, the CAAG alleges that "[f]rom the early 1970s to December 2008, Chais served as one of the largest feeder funds to Madoff, funneling hundreds of millions of dollars into Madoff's Ponzi scheme." (Cole Decl. Ex. J ¶¶ 16–20, 29.) The CAAG further alleges that the management fees earned by Chais were calculated based upon the amount of "profits" purportedly earned by the Chais Funds. (*Id.* ¶ 21.) As discussed above, the Trustee's investigation to date has demonstrated that Chais took these management fees out of "profits" withdrawn from BLMIS accounts before those "profits" were distributed to the relevant Fund or investor. (Cole Decl. ¶ 8.) Thus, the CAAG seeks the same hundreds of millions of dollars that were fraudulently transferred by BLMIS to Chais and that are sought by the Trustee.

d. Demurrers to Amended Complaints and Future Proceedings

(1) Demurrers to Amended Complaints

On or about August 10, 2010, Chais Defendants William Chais, Wrenn Chais, Emily Chasalow and Michael Chasalow and the Related Trusts and Related Companies[20] (collectively, the "Chais Related Entities") filed a demurrer to counts five and six (unjust enrichment, constructive trust, and fraudulent transfer) of the Third Amended Complaint filed by the *Bottlebrush* Plaintiffs. (Cole Decl. Ex. K.) On or about the same date, the Chais Related Entities filed a demurrer to counts seven (unjust enrichment and constructive trust), sixteen and seventeen (both asserting fraudulent conveyances) of the Second Amended Complaints in the *Hall* and *Heimoff* Actions. (*Id.*) Further, Stanley Chais, Pamela Chais, Appleby Productions Ltd. Appleby Productions Defined Contribution Plan, Appleby Productions Ltd. Money Purchase Plan, Appleby Productions Ltd. Profit Sharing Plan, and the 1991 Chais Family Trust (collectively, the "Stanley Chais Defendants") filed a demurrer to counts two (breach of fiduciary duty on behalf of Lambeth (Hall) or Popham (Heimoff)), three (breach of fiduciary duty on behalf of the Crescent (Hall) or Marloma (Heimoff)), five and six (aiding and abetting breach of fiduciary duty), seven (unjust enrichment and constructive trust), as well as counts eleven and twelve (breach of contract), fourteen and fifteen (common law fraud), and sixteen and seventeen (fraudulent conveyance) of the Second Amended Complaints in the *Hall* and *Heimoff* Actions. (*Id.*)

[20] Defined in the demurrer as the 1994 Trust for the Children of Stanley and Pamela Chais, the 1996 Trust for the Children of Pamela Chais and Stanley Chais, the 1999 Trust for the Grandchildren of Stanley and Pamela Chais, the Emily Chais Trusts, the Mark Hugh Chais Trusts, the William Frederick Chais Trusts, William Chais and Wrenn Chais 1994 Family Trust dated 4/25/95, the Ari Chais 1999 Trust, the Ari Chais Transferee #1 Trust, the Benjamin Paul Chasalow 1999 Trust, the Benjamin Paul Chasalow Transferee #1 Trust, the Chloe Francis Chais 1994 Trust, the Chloe Francis Chais Transferee #1 Trust, the Jonathan Wolf Chais Trust, the Jonathan Chais Transferee #1 Trust, the Justin Robert Chasalow 1999 Trust, the Justin Robert Chasalow Transferee # 1 Trust, the Madeline Celia Chais 1992 Trust, the Madeline Chais Transferee # 1 Trust, the Rachel Allison Chasalow 1999 Trust, the Rachel Allison Chasalow Transferee #1 Trust, the Tali Chais 1997 Trust, and the Tali Chais Transferee #1 Trust (the "Chais Related Trusts"); and the Unicycle Trading Company, Unicycle Corporation, Onondaga, Inc., Chais Investments, Ltd., Chais Management, Inc., Chais Management, Ltd., and Chais Venture Holdings (the "Chais Related Companies").

On September 15, 2010 the California Superior Court held a hearing on the demurrers. With respect to the *Bottlebrush* Complaint, the court sustained the demurrer with leave to amend as to the fifth and sixth causes of action.[21] As discussed below, those causes of action—nominally for fraudulent transfer and for unjust enrichment—were found "to violate the automatic stay of the BLMIS bankruptcy." (Cole Decl. Ex. L at 3.) The court found:

> The TAC alleges that Chais took hundreds of millions of dollars and opened the Chais Family Accounts at BLMIS for his family and his children and grandchildren. TAC ¶ 66. The TAC alleges that the Trusts were reaping the benefits of Madoff's Ponzi scheme at the expense of the Plaintiffs. TAC ¶ 66. Over the years, millions of dollars in cash were withdrawn from the Chais Family Accounts and distributed to the beneficiaries of the Chais Family Trusts. TAC ¶ 66. Accordingly, the Plaintiffs attempt to secure a transfer from BLMIS to the Chais Related Entities.

(*Id.*) Citing this Court's decision in *Picard v. Fox*, 429 B.R. 423 (Bankr. S.D.N.Y. 2010), the court held that "to the extent that any claims are to the allegedly fraudulently transferred assets from BLMIS estate, they belong to the estate for fair distribution to all appropriate creditors." (Cole Decl. Ex. L at 4.) ("Indeed, in *Picard, Esq. v. Fox and Marshall*, Case No. 10-3114, the United States Bankruptcy Court enjoined class action lawsuits seeking a constructive trust consisting of ill-gotten gains received by the Defendants stating that although not labeled as such, the claims seek recovery of funds fraudulently transferred by BLMIS.") The court granted leave to amend by November 15, 2010, and scheduled a hearing on future demurrers for February 8, 2011.

With respect to the Second Amended Complaints in the *Hall* and *Heimoff* Actions, the court, for reasons unrelated to the automatic stay, sustained with leave to amend the Chais Related Entities' demurrer to counts 7, 16, and 17, and sustained with leave to amend the Stanley Chais Defendants' demurrer to counts 5 and 16. The court overruled the Stanley Chais

[21] Further, the court sustained the *Bottlebrush* Plaintiffs' demurrers to cross-complaints filed by Brighton against Leghorn and Lambeth against Bottlebrush, with leave to amend in 30 days. (Cole Decl. Ex. L.)

Defendants' demurrer to counts 2, 7, 11, and 14.[22] Notably, unlike in *Bottlebrush*, the court rejected the argument that the fraudulent conveyance and unjust enrichment claims violated the BLMIS automatic stay. (Cole Decl. Ex. L at 4-5, 9.) In doing so, the court reasoned that—unlike the fraudulent conveyance and unjust enrichment claims in *Bottlebrush*, which sought to recover transfers from BLMIS—the corresponding claims in *Hall* and *Heimoff* sought to recover management fees paid to Chais, which did not emanate from BLMIS. (*Id.*) However, as discussed herein, the management fees received by Chais did emanate from, and constitute fraudulent transfers from, BLMIS. Based on the Trustee's investigation to date, Chais took these management fees out of "profits" withdrawn from BLMIS accounts before those "profits" were distributed to the relevant Fund or investor. (Cole Decl. ¶ 8.) As such, the management fees consist of customer property fraudulently transferred directly from BLMIS.[23]

(2) Future Proceedings

On May 6, 2011, the Trustee wrote a letter to the Third Party Plaintiffs stating his position that the *Bottlebrush* Action violates the automatic stay and otherwise should not proceed until the Trustee's action has been concluded. (Cole Decl. Ex. O.) This letter was submitted to the California Superior Court with the parties' pleadings.

On November 2, 2011, the California Superior Court issued a written tentative ruling finding that the Stanley Chais Defendants (including the Chais estate and certain Chais entities) did not have standing to assert a violation of the automatic stay, and indicating that the Third-Party Plaintiffs' claims against the Stanley Chais Defendants may proceed unless the Trustee

[22] The court found Stanley Chais's demurrer to counts 3, 6, 12, 15, and 17 of the action, brought on behalf of Crescent alternatively in case the identical claims against Lambeth were not sustained, moot in light of the court's ruling that Hall had standing to assert claims on behalf of Lambeth. (Cole Decl. Ex. L.) Further, the court sustained the *Hall* Plaintiffs' demurrers to cross-complaints filed by Lambeth against Hall and Popham against Heimoff. (*Id.*)

[23] On September 15, 2011, by court order, defendants Mirie Chais and Michael Chasalow were dismissed from the *Bottlebrush* Action.

moved either before it or before this Court to enforce the automatic stay. (Cole Decl. Ex. M at 2.) The Superior Court recognized that the *Bottlebrush* Plaintiffs "risk proceeding to a judgment that may be voidable as being taken in violation of the automatic stay and possibly set aside at the bankruptcy trustee's election . . . " and "risk incurring substantial attorneys[']fees and costs to obtain a judgment which might end up being largely unenforceable." (*Id.* at 3.) In light of these risks, the Superior Court invited the Trustee to seek to enforce the automatic stay and pursue injunctive relief. (*Id.*) The Superior Court continued the hearing on the demurrer filed by the Stanley Chais Defendants to the *Bottlebrush* Fourth Amended Complaint, and scheduled a hearing for November 29, 2011. (*Id.*)

On November 22, 2011, the Trustee again wrote to the California Superior Court asking that the hearing be adjourned to January 4, 2012, so that the parties could have the benefit of District Court hearings that were pending concerning appeals of this Court's issuance of injunctions in *Picard v. Stahl*, Adv. Pro. No. 10-03268 (Bankr. S.D.N.Y. filed May 27, 2010) and *Picard v. Picower*, Adv. Pro. No. 09-01197 (Bankr. S.D.N.Y. filed May 12, 2009). (Cole Decl. Ex. O at 2.) The Court declined to adjourn the hearing, which went forward on November 29, 2011. At that hearing, the court stated that it would proceed to a determination of the applicability of the automatic stay, and indicated an inclination to permit certain of the Third Party Plaintiffs' claims against the Chais Defendants to go forward, to the extent it deems such claims independent and/or seeking different assets from the Trustee's claims. Although the Trustee did not formally appear, his counsel was permitted a special telephonic appearance to state his intent to take action before January 4, 2012, the date he previously had requested. The Superior Court stated that, given its schedule, its decision might not issue before that date. (Cole Decl. Exs. O, P.)

F. Certain of the Third Party Plaintiffs Filed Claims with the Trustee

Third Party Plaintiffs Hall and Heimoff availed themselves of the Claims Procedures Order and filed claims with the Trustee. (Affidavit of Matthew Cohen in Support of Trustee's Application for Enforcement of Automatic Stay and Preliminary Injunction ("Cohen Aff.") Exs. A, C.) On or about June 24, 2009, Third Party Plaintiff Hall filed customer claims with the Trustee with regard to underlying investments with Lambeth that the Trustee has designated as Claims ## 012067 and 012688. On or about March 18, 2009, Third Party Plaintiff Heimoff filed a customer claim with regard to his underlying investments in Popham that the Trustee designated as Claim # 008370. The Trustee denied each of these claims because these Third Party Plaintiffs did not hold accounts at BLMIS.[24] (Cohen Aff. Exs. B, D.)

The CAAG has not filed a customer claim with the Trustee. However, numerous investors in the Chais Funds—investors whom the CAAG purports to represent—have filed customer claims with the Trustee. (Alix Aff. ¶ 3 .) These customer claims, including customer claims filed by the Third-Party Plaintiffs, have been denied by the Trustee on the ground that the investors in the Chais Funds did not hold accounts at BLMIS. (*Id*.)

G. The Third Party Actions' Allegations Mimic the Allegations in the Trustee's Chais Complaint

The Third Party Plaintiffs seek to recover from the pool of customer property that was improperly transferred to the Chais Defendants. This is the same property the Trustee seeks to

[24] Hall additionally filed customer claims with the Trustee with regard to underlying investments with Popham that the Trustee has designated as Claims ## 012066 and 012687, and investments with Lambeth through a vehicle other than Crescent, Claims ## 012068 and 012686. Likewise, Heimoff also filed a customer claim with regard to an underlying investment in Lambeth that the Trustee designated as Claim # 009100. These claims are not directly relevant to the instant matter, given that such claims do not relate to the particular Chais Fund or sub-entity on whose behalf Hall and Heimoff respectively purport to assert derivative claims in their state-court actions. These claims, like the above-described claims filed by Hall and Heimoff, have been denied by the Trustee because Hall and Heimoff did not hold accounts at BLMIS.

recover in the Trustee's Chais Action, property that should be returned to the estate for equitable distribution to BLMIS creditors under the distribution scheme established by SIPA.

The Trustee outlines in his complaint the extent to which, the mechanisms by which, and the form in which property was transferred from BLMIS to the Chais Defendants. These transfers received by the Chais Defendants were of BLMIS funds, which are, themselves, customer property. The Third Party Plaintiffs' complaints are based on the same operative facts as those alleged in the Trustee's complaint. Indeed, the Third Party Plaintiffs' complaints in some places simply parrot the Trustee's own allegations. (*See, e.g.*, Cole Decl. Ex. F ¶ 101 ("Chais knew, or should have known, that Madoff was engaged in fraud rather than real trading activity based on the fact that the Chais Family Accounts received drastically higher rates of return than those reported for the Partnerships."); Tr. Compl. ¶ 103(b) ("Chais knew or should have known that Madoff was engaged in fraud rather than real trading activity based on the fact that the Chais Family Accounts received drastically higher rates of returns than those reported for the Chais Fund accounts during the same time periods."); Cole Decl. Ex. F ¶ 34 ("Unbeknownst to Plaintiffs, Chais had been closely associated with Madoff on both a business and social level since at least the 1960s."); Tr. Compl. ¶ 33 ("On information and belief, Chais has been closely associated with Madoff on both a business and social level since at least the 1970s"); Cole Decl. Ex. J. (CAAG Amended Complaint) ¶ 16 ("Chais[' . . .] phone number appeared as the first speed dial entry on a telephone list at Madoff's office."); Tr. Compl. ¶ 99 ("Chais' telephone number appears as the first speed dial entry on a telephone list at BLMIS.").)

More tellingly, the Third Party Plaintiffs for their complaints explicitly rely on the Trustee's allegations. (See Cole Decl. Ex. F ¶ 98 ("The Trustee for the liquidation of B[L]MIS, after gaining access to B[L]MIS' records, concluded that Chais was complicit in Madoff's Ponzi

scheme and utilized his longstanding relationship with Madoff to create huge wealth for himself and his family."); *id.* ¶ 101 ("According to information available to the trustee of the estate of B[L]MIS . . . the Chais Family Accounts obtained an even higher rate of return than the Partnerships' unrealistic rates of return. . . . As such, Chais should have ensured that the Partnerships adopted the same investment strategy as the Chais Family Accounts and therefore received an equivalent rate of return, but he did not do so."); Cole Decl. Ex. I (Fourth Amended Complaint) ¶ 65 ("The Trustee for the liquidation of BLMIS, after gaining access to BLMIS's records, concluded that Chais was complicit in Madoff's Ponzi scheme and utilized his longstanding relationship with Madoff to create huge wealth for himself and his family.").)

As discussed above, the Third Party Plaintiffs themselves make clear that (1) the damages they seek are recovery of funds invested into BLMIS, and (2) that the Chais Defendants wrongfully received fees and/or other money distributed from BLMIS by various mechanisms. (*See e.g.*, Cole Decl. Ex. F ¶ 94 ("Chais, the Chais-Related Individuals, the Chais entities, and the Chais Trusts benefitted from the distribution and receipt of hundreds of millions of dollars of so-called fees . . . "); *id.* ¶ 125 ("Chais directed the transfer of funds between the Chais Family Accounts and the Chais Trusts, and directed payments to and among the Chais Family Accounts and the Chais Trusts. Chais also distributed part or all of his wrongfully acquired 'management fees' to the Chais Trusts."); *id.* ¶ 200 ("Chais and Pamela Chais transferred money to the Chais Related Individuals and the Chais Entities, in their own capacity and in their capacity as trustees of the Chais Trusts, in a deliberate and intentional attempt to hinder and avoid claim such as those asserted in this Complaint."); *id.* ¶¶ 12, 20, 21, 24-25, 94-97, 100, 103, 105, 108, 113, 118, 123, 125, 144, 153(c), 158(c), 166, 171, 185(c), 190(c), 194, 195(c), 202; Cole Decl. Ex. I (Fourth Amended Complaint) ¶¶ 62, 63 ("Chais was paid 25% of the profits reflected on the

statements for his purported services – totaling hundreds of millions of dollars – even though he failed to undertake any supervisory role over the performance of the investments of the Chais Investment Partnerships, instead abdicating all responsibility to BLMIS."); *id.* ¶ 64 ("Chais then opened the Chais Family Accounts at BLMIS for his family . . . Chais knew, or should have known, that Madoff was engaged in fraud . . . and that he and the Chais Family Trusts were reaping the benefits of an illegal investment scheme at the expense of Lambeth, Brighton, and their limited partners."); *id.* ¶ 90 ("Under these circumstances, equity and good conscience mandate that the Chais estate return the unjustly gained monies to Lambeth and Brighton. Any judgment entered on this cause of action should include the Trustees [of the Chais Family Trusts] as parties liable for the damages because there is such a unity of interest and control by Chais over the Trustees that to recognize the existence of the Chais Family Trusts and the Trustees as separate and distinct from Chais would sanction a fraud and promote injustice."), *id.* ¶¶ 67(a)-(d), 73, 76, 83-84, 89, 90, Prayer for judgment (seeking, *inter alia*, damages and a constructive trust); Cole Decl. Ex. J (CAAG Amended Complaint) ¶ 1 ("Chais, who fashioned himself as an 'investment wizard,' collected over $250 million in fees supposedly for exercising his skill and judgment in managing investments. In fact, all Chais did was turn over the entirety of his investors' capital to Madoff without their knowledge or authorization and despite numerous indicia that Madoff was running a fraudulent scheme."); *id.* ¶¶ 21-23, 36.

As the Trustee alleges in his Complaint, the Chais Defendants received over a billion dollars in fraudulent transfers of fictitious profit from BLMIS, which consist of other customers' property. The Trustee seeks to recover this property via his action against the Chais Defendants. The Third Party Plaintiffs seek to recover from this same limited pool of funds, to the detriment of other customers of BLMIS.

ARGUMENT

I. THIS COURT HAS JURISDICTION OVER THE THIRD PARTY ACTIONS AND THIRD PARTY PLAINTIFFS

A. This Court Has Subject Matter Jurisdiction Over All of the Third Party Actions and Personal Jurisdiction over the Third Party Plaintiffs

This Court has subject matter jurisdiction to enjoin the Third Party Actions pursuant to 28 U.S.C. §§ 1334(b), 157(a), 157(b), and the Standing Order of Referral of Cases to Bankruptcy Judges of the United States District Court for the Southern District of New York, dated July 10, 1984 (Ward, Acting C.J.).

Pursuant to 28 U.S.C. § 1334(b), district courts (and hence bankruptcy courts) have original jurisdiction of civil proceedings "arising under" and "arising in" and "related to" cases under Title 11. *See Adelphia Commc'ns Corp. v. The American Channel, LLC, et al. (In re Adelphia Commc'ns Corp.)*, 2006 WL 1529357, at *6 (Bankr. S.D.N.Y. June 5, 2006). Furthermore, bankruptcy courts have jurisdiction to "hear and determine . . . all core proceedings arising under Title 11, or arising in a case under Title 11 . . . ." 28 U.S.C. § 157(b)(1). *See also* SIPA § 78eee(b)(4). 28 U.S.C. §§ 157(b)(2)(A) and (B) provide that core proceedings include, but are not limited to, "matters concerning the administration of the estate . . ." and the "allowance or disallowance of claims against the estate." As this Court has held, in the Second Circuit, the test for determining whether "related to" jurisdiction exists is whether the outcome of a proceeding "might have any 'conceivable effect' on the bankruptcy estate." *See Picard v. Stahl,* 443 B.R. 295, 310-11 (Bankr. S.D.N.Y. 2011) (Lifland, J.), *aff'd* Summary Order, *Fairfield Retirement Program v. Picard,* 11-CV-2392, ECF No. 26 (Dec. 5, 2011) ("*Stahl* Summary Order"); *see also Adelphia*, 2006 WL 1529357, at *4; *Publicker Indus. Inc. v. U.S.* (*In re Cuyahoga Equip. Corp.*), 980 F.2d 110, 114 (2d Cir. 1992); *Fisher v. Apostolou*, 155 F.3d 876, 882 (7th Cir. 1998); *Stern v. Marshall*, -- U.S. --, 131 S.Ct. 2594, 2620 (2011) (the *Stern*

holding does not "meaningfully change[] the division of labor" in the current bankruptcy system); Order of U.S. District Court Judge William H. Pauley, III signed on 12/22/2011, at 13, *Picard v. Madoff*, 11-Misc.-0379 (WHP) (S.D.N.Y.) (noting that, under *Stern*, bankruptcy courts retain authority to determine common law claims to the extent required to determine the allowance or disallowance of claims).[25]

That the Third Party Actions seek the proceeds of fraudulent transfers and would undermine the orderly administration of the liquidation of BLMIS and the Trustee's efforts to recover customer property and satisfy claims against BLMIS provides "arising under," "arising in," and "related to" jurisdiction to this Court. *See, e.g.*, *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 91-92 (2d Cir. 1988); *Adelphia*, 2006 WL 1529357, at *6-7; *In re AP Indus., Inc.*, 117 B.R. 798, 798 (Bankr. S.D.N.Y. 1990).

In addition, this Court has inherent ancillary jurisdiction concerning the Third Party Actions beyond the statutory grant of authority in order to interpret and enforce this Court's orders:

> Bankruptcy courts have inherent or ancillary jurisdiction to interpret and enforce their own orders wholly independent of the statutory grant of jurisdiction under 28 U.S.C. § 1334. Bankruptcy Courts must have the ability to enforce prior orders and secure or preserve the fruits and advantages of a judgment or decree rendered therein . . . . The proceeding being ancillary and dependent, the jurisdiction of the Court follows that of the original cause . . . .

[25] "Proceedings 'related to' the bankruptcy estate include (1) causes of action owned by the debtor which become property of the estate pursuant to 11 U.S.C. § 541, and (2) suits between third parties which have an effect on the bankruptcy estate." *Celotex Corp. v. Edwards*, 514 U.S. 300, 308, n.5 (1995). The Trustee's Chais Action and the Third Party Actions all relate to and are based on Madoff's fraud and the Chais Defendants' involvement in that fraud. Hence, as discussed further herein, the prosecution of the Third Party Actions will have a significant effect on the administration of the bankruptcy estate.

LTV Corp. v. Back (*In re Chateaugay Corp.*), 201 B.R. 48, 62 (Bankr. S.D.N.Y. 1996) (Lifland, J.), *aff'd in part*, 213 B.R. 633 (S.D.N.Y. 1997) (internal citations and quotations omitted).[26]

This Court also has personal jurisdiction over Third Party Plaintiffs Hall and Heimoff because they have filed customer claims with the Trustee in the BLMIS liquidation. As this Court has noted, "[i]t is well settled that by filing a proof of claim, a creditor submits to the bankruptcy court's equitable jurisdiction regarding adjudication of matters related to that claim, including avoidance actions." *Stahl*, 443 B.R. at 310 (*citing Langenkamp v. Culp*, 498 U.S. 42, 44 (1990)). A customer claim filed in a SIPA action is the equivalent of a proof of claim filed in a typical bankruptcy proceeding for purposes of submission to jurisdiction. *Stahl*, 443 B.R. at 310; *Keller v. Blinder* (*In re Blinder Robinson & Co.*), 135 B.R. 892, 896-97 (D. Col. 1991). In addition, the bankruptcy court has personal jurisdiction over the Third-Party Plaintiffs to the extent necessary to protect its own jurisdiction over the property of the estate and to enforce the automatic stay. *See* 11 U.S.C. § 362(a) ("[A]n application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 [. . .] operates as a stay, *applicable to all entities . . .* " (emphasis added)); § 101(15) ("The term 'entity' includes person, estate, trust, governmental unit, and United States trustee.").

[26] The U.S. Supreme Court's recent ruling concerning bankruptcy courts' constitutional authority in *Stern v. Marshall*, -- U.S. --, 131 S.Ct. 2594 (2011) has no bearing on this Court's subject-matter jurisdiction over the Third Party Plaintiffs. *See In re Teleservices Group, Inc.*, 456 B.R. 318, 335-36 (Bankr. W.D. Mich. 2011) ("Therefore, it does not appear that *Stern* limits my ability under Authority Section 157(b)(2)(G) to enter final orders regarding the modification of the automatic stay."); *In re Ambac Financial Group, Inc.*, 457 B.R. 299, 308 (Bankr. S.D.N.Y. 2011) (*Stern* does not divest bankruptcy courts of jurisdiction to settle third-party claims). Likewise, *Stern* does not impact this Court's personal jurisdiction over Third-Party Plaintiffs who filed customer claims with the Trustee, as this Court will not be finally adjudicating the Third-Party Actions.

B. Because the CAAG Cannot Raise a Sovereign Immunity Defense, the Court Also Has Jurisdiction to Enforce the Automatic Stay and Stay Orders Against the CAAG Action and Otherwise Enjoin the CAAG

The CAAG may argue that the relief sought herein violates the sovereign immunity clause of the Eleventh Amendment to the United States Constitution. U.S. CONST. amend. VI. However, the Supreme Court has held that "[i]n ratifying the Bankruptcy Clause [of the Constitution], the States acquiesced in a subordination of whatever sovereign immunity they might otherwise have asserted in proceedings necessary to effectuate the *in rem* jurisdiction of the bankruptcy courts." *See Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 377-78 (2006) (internal citations omitted); *see also Ace Am. Ins. Co. v. DPH Holdings Corp. (In re DPH Holdings Corp.)*, 437 B.R. 88, 99 (S.D.N.Y. 2010). Because the relief sought by the Trustee herein expressly seeks to enjoin the CAAG Action to preserve and protect *property* of BLMIS's estate for distribution in accordance with the Bankruptcy Code and SIPA, it falls squarely within the bankruptcy court's *in rem* jurisdiction and does not implicate sovereign immunity.

Moreover, and significantly, the CAAG cannot invoke sovereign immunity when it sues on behalf of private citizens who are the real parties in interest in the litigation, which is the case in the instant matter to the extent the CAAG seeks fraudulently transferred funds on behalf of California investors in BLMIS funds. *See, e.g., In re Baldwin-United Corp.*, 770 F.2d 328, 341 (2d Cir. 1985) (holding that injunction against forty state attorneys general acting in a representative capacity did not contravene the Eleventh Amendment); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cavicchia*, 311 F. Supp. 149, 156 (S.D.N.Y. 1970) (holding that the New York Attorney General was not the real party in interest where any property recovered could only be held for the benefit of defrauded New York investors); *Finkielstain v. Seidel*, 857 F.2d

893, 896 (2d Cir. 1988) (state agency acting as receiver for insolvent bank not entitled to Eleventh Amendment immunity).[27]

II. THE THIRD PARTY ACTIONS VIOLATE THE EXISTING STAYS AND SHOULD OTHERWISE BE PRELIMINARILY ENJOINED

A. The Third Party Actions Violate the Stay Orders and Automatic Stay

Both the Trustee and the Third Party Plaintiffs seek to recover customer property. The Third Party Actions violate the automatic stay, as well as the Stay Orders and the Claims Procedures Order, as the Third Party Plaintiffs seek to side-step the claims administration process established by this Court and to tap into the same pool of money as the Trustee. Accordingly, the Third Party Actions cannot be allowed to continue and should be enjoined.

1. The Automatic Stay Applies

Section 362(a)(3) of the Bankruptcy Code provides that the filing of an application for the entry of a protective decree under section 5(a)(3) of SIPA (15 U.S.C. § 78eee(a)(3)) operates as a stay, applicable to all persons and entities of, *inter alia*, any act to exercise control over property of the estate. *See* 11 U.S.C. § 362(a)(3).[28] Similarly, section 362(a)(1) bars "the commencement or continuation . . . of a judicial . . . or other action or proceeding against the debtor . . . or to recover a claim against the debtor . . . ." 11 U.S.C. 362(a)(1). A "claim against the debtor" encompasses claims against third parties, such as claims for fraudulently transferred funds, that are tantamount to claims against the debtor. *See FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125, 132 (2d Cir. 1992). Finally, section 362(a)(6) bars "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case."

[27] In addition, the exception to sovereign immunity set forth in the U.S. Supreme Court's seminal decision, *Ex parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908), applies because the Trustee is not suing the State of California but instead is seeking prospective injunctive relief against the CAAG.

[28] Furthermore, SIPA § 78eee(b)(2)(B) also provides for stay protection as to, *inter alia*, any suit against a debtor's property.

11 U.S.C. 362(a)(6). Thus, the automatic stay bars actions, like the ones at issue here, that seek recovery of (or recovery out of) the same fraudulent transfers sought by the Trustee and are therefore seeking to collect on the Trustee's fraudulent transfer claim against the debtor. Each of these provisions of section 362(a) is designed to prevent the dismemberment of the bankruptcy estate through interference, either directly or indirectly, with the trustee's control over estate property. *See, e.g., Liberty Mut. Ins. Co. v. Off. Unsecured Creditors' Comm. of Spaulding Composite Co., Inc.* (*In re Spaulding Composites Co., Inc.*), 207 B.R. 899, 908 (9th Cir. BAP 1997); *In re Burgess*, 234 B.R. 793, 799 (D. Nev. 1999); *In re HSM Kennewick, L.P.*, 347 B.R. 569, 572 (Bankr. N.D. Tex. 2006).

"The automatic stay is one of the most fundamental bankruptcy protections . . . ." *Picard v. Fox*, 429 B.R. 423, 430 (Bankr. S.D.N.Y. 2010). The stay provision is broad, and "prevents creditors from reaching the assets of the debtor's estate piecemeal and preserves the debtor's estate so that all creditors and their claims can be assembled in the bankruptcy court for a single organized proceeding." *In re AP Indus., Inc.*, 117 B.R. at 798 (citations omitted). Similarly, in this case's SIPA context, the automatic stay "protects customers of BLMIS by fostering fair, uniform, and efficient distribution of customer property." *Picard v. Fox*, 429 B.R. at 430. The automatic stay is intended precisely to prevent those creditors who are able to act first from obtaining payment "in preference to and to the detriment of other creditors . . . [,]" which would be the exact result if any of the Third Party Actions were successfully prosecuted before the conclusion of the Trustee's Chais Action. *See In re AP Indus.*, 117 B.R. at 799 (*citing* H.R. REP. NO. 595, 95th Cong., 1st Sess. 340 (1977); S. REP. NO. 989, 95th Cong. 2d Sess. 49 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5835, 5963, 6296-97); *In re Keene Corp.*, 164 B.R. 844, 849 (Bankr. S.D.N.Y. 1994) ("equality . . . is the governing principle").)

2. The Stay Orders Apply

In an order entered on December 15, 2008, the District Court declared that "all persons and entities are stayed, enjoined and restrained from directly or indirectly . . . interfering with any assets or property owned, controlled or in the possession of [BLMIS]." *SEC v. Bernard L. Madoff*, 08-CIV-10791 (LLS), ECF No. 4 ¶ IV (reinforcing automatic stay); *see also* Order on Consent Imposing Preliminary Injunction Freezing Assets and Granting Other Relief Against Defendants, Dec. 18, 2008, ECF No. 8, IX ("no creditor or claimant against [BLMIS], or any person acting on behalf of such creditor or claimant, shall take any action to interfere with the control, possession or management of the assets subject to the receivership."); Partial Judgment on Consent Imposing Permanent Injunction and Continuing Other Relief, Feb. 9, 2009, ECF No. 18, IV (incorporating and making the December 18, 2008 stay order permanent).

The Stay Orders are clearly applicable here, as the Third Party Plaintiffs are interfering with potential estate assets. *See Picard v. Fox*, 429 B.R. at 433; *Stahl*, 443 B.R. at 315, *aff'd Stahl* Summary Order.

B. The Third Party Plaintiffs Seek the Recovery of Fraudulent Transfers Made to the Chais Defendants in Violation of Section 362(a)(1)

1. The Third Party Plaintiffs Explicitly Seek Recovery of Fraudulent Transfers

The Third Party Actions seek the recovery of funds fraudulently transferred by BLMIS to the Chais Defendants. The *Hall* and *Bottlebrush* Plaintiffs explicitly seek recovery based on fraudulent conveyance claims. (See Cole Decl. Ex. E ¶¶ 199-202; *id*. Ex. I ¶¶ 91-96.) In their Third Amended Complaint—the version immediately preceding the complaint currently pending in California state court—the *Bottlebrush* Plaintiffs made no attempt to hide that the money they seek to recover from the Chais Defendants in such claims consists of fraudulent transfers from BLMIS. Among other things, the Bottlebrush Third Amended Complaint alleged that:

> Chais simply turned over all the funds he solicited from the investors in the Chais Investment Partnerships to BLMIS. Madoff then issued false accounting statements to Chais which showed remarkably consistent positive returns on investment. Pursuant to his written agreements with the Chais Investment Partnerships, Chais was paid 25% of the profits reflected on the statements for his purported services—totaling hundreds of millions of dollars . . . .

(*Id.* Ex. I (Third Amended Complaint) ¶ 65.)

> *Chais then took these hundreds of millions of dollars and opened the Chais Family Accounts at BLMIS for his family, his children and grandchildren . . .* Pursuant to Chais' fraudulent scheme, and at his direction and under his control, *over the years hundreds of millions of dollars in cash was withdrawn from the Chais Family Accounts and distributed to the beneficiaries of the Chais Family Trusts.*

(*Id.* ¶ 66 (emphasis added).)

The Superior Court sustained a demurrer to two counts contained in the Third Amended Complaint—unjust enrichment and fraudulent conveyance—because these allegations demonstrated that the claims "violate the automatic stay of the BLMIS bankruptcy." (Cole Decl. Ex. L at 3.) The court noted that the unjust enrichment claim was "identical to the fraudulent conveyance action and however labeled is really a claim for fraudulent conveyance." (*Id.* at 5.)

In their Fourth Amended Complaint, the *Bottlebrush* Plaintiffs have again brought counts for unjust enrichment and fraudulent conveyance, but this time, have chosen to omit any explicit reference to the management fees' trajectory through BLMIS. Thus, the current version of the Complaint alleges that:

> . . . Chais simply turned over all the funds he solicited from the investors in the Chais Investment Partnerships to BLMIS. BLMIS then issued false accounting statements to Chais which showed remarkably consistent positive returns on investment. Pursuant to his written agreements with the Chais Investment Partnerships, Chais was paid 25% of the profits reflected on the statements for his purported services—totaling hundreds of millions of dollars . . . .

(Cole Decl. Ex. I (Fourth Amended Complaint) ¶ 63.)

> *Chais then opened the Chais Family Accounts at BLMIS* for his family, his children and grandchildren. . . . Pursuant to Chais' fraudulent scheme, and at his

> direction and under his control, *over the years hundreds of millions of dollars in cash was distributed to his children and other family members*.

(*Id.* ¶ 64 (emphasis added).)

The *Bottlebrush* Plaintiffs' attempt to plead around the facts cannot change those facts, and omitting the details of the fraudulent transfers does not transform them into something else. The *Bottlebrush* Plaintiffs assert fraudulent conveyance claims, and seek, with or without the omitted language, money consisting of fraudulently transferred BLMIS customer property, the same fraudulent transfers sought by the Trustee. The unjust enrichment count is, as in the Third Amended Complaint, a disguised claim for fraudulent transfers.

In their fraudulent conveyance count, the *Bottlebrush* Plaintiffs have alleged specific transfers by and between the Chais Defendants that, they allege, "were not made by or through any BLMIS account." (Cole Decl. Ex. I (Fourth Amended Complaint) ¶ 93.) But these allegations merely detail subsequent transfers of funds that originated from BLMIS and that consist of BLMIS customer property. The Trustee also has alleged that the Chais Defendants were subsequent transferees and intends to, as he is entitled to do, pursue the recovery of customer property from subsequent transferees to the same extent as he will from initial transferees. (Cole Decl. Ex. A ¶¶ 164-169.) Allegations that the Chais Defendants transferred funds among themselves does not help the *Bottlebrush* Plaintiffs escape the fact that the source of those funds was BLMIS customer property and should be recovered for equitable distribution as provided for in SIPA.

The automatic stay prohibits such actions: "a third-party action to recover fraudulently transferred property is properly regarded as undertaken 'to recover a claim against the debtor' and subject to the automatic stay pursuant to § 362(a)(1)." *FDIC v. Hirsch* (*In re Colonial Realty Co.*), 980 F.2d 125, 131–32 (2d Cir. 1992). Such claims by creditors based on the

fraudulent transfer of the debtor's assets are foreclosed by the seminal *Colonial Realty* decision. *See id*. at 132; *see also In re Keene Corp*., 164 B.R. at 850 ("Where a [debtor's] creditor seeks to recover his or her claim from a transferee of [the debtor's] property, the creditor's action is stayed by section 362(a)(1)"); *Crysen/Montenay Energy Co. v. Esselen Assocs. Inc.* (*In re Crysen/Montenay Energy Co*.), 902 F.2d 1098, 1103 (2d Cir. 1990) (unsecured creditor may not obtain priority over other unsecured creditors, and action by such creditor to recover its claim against third party defendant found to be in violation of stay). Similarly, the Third-Party Plaintiffs' attempt to recover fraudulent transfers should be barred.

2. The Third Party Plaintiffs Seek Recovery of Disguised Fraudulent Transfers

Virtually the only money Chais, the Chais Funds, and the Chais Trusts have is money that was wrongfully transferred as part of Madoff's Ponzi scheme. (Cole Decl. ¶¶ 5, 7.) Similarly, the assets of the remaining Chais Defendants are, collectively, less than the amount that was wrongfully transferred as part of Madoff's Ponzi scheme and that the Trustee seeks to recover on behalf of all BLMIS customers and creditors. (*Id.*) Thus, all of the Chais Defendants' assets are recoverable by the Trustee. (*See also* Tr. Compl. ¶¶ 99, 164-69.)

The Chais Funds were completely, or substantially completely, invested in BLMIS during the relevant period. (Cole Decl. ¶ 5.) Further, as alleged in the Trustee's Complaint, Chais received hundreds of millions of dollars in "management fees" from BLMIS, which he transferred to and among various Chais Defendants' accounts at BLMIS. (Cole Decl. Ex. A ¶ 99.) These management fees consisted primarily of money belonging to other BLMIS customers. (*See* Cole Decl. ¶ 8.) More than $1 billion in "fictitious profits"—other customers' money—was transferred from BLMIS to the Chais Defendants, more than the Chais Defendants' current assets combined. (Cole Decl. ¶ 6).

The Third Party Actions seek a recovery of the management fees, "unjustly gained monies," and compensation received by the Chais Defendants in connection with BLMIS, (Cole Decl. Ex. I (Fourth Amended Complaint) ¶ 90, *id.* Ex. F ¶ 174, *id.* Ex. J at 15), as well as a finding that "the Chais Estate . . . holds its assets as constructive trustee for the benefit of the creditors of the Chais Estate . . . ." (*Id.* Ex. F ¶ 175.) As discussed above, the management fees, "unjustly gained monies," and compensation that the Third Party Plaintiffs seek are the funds that were fraudulently transferred from BLMIS to the Chais Defendants. Based on the Trustee's investigation to date, Chais took these management fees out of "profits" withdrawn from BLMIS accounts before those "profits" were distributed to the relevant Fund or investor. (*See* Cole Decl. ¶ 8.)

Just as the Third Party Plaintiffs' explicit attempt to recover fraudulent transfers violates section 362(a)(1), the automatic stay likewise precludes the Third Party Plaintiffs' attempt to recover from the proceeds of fraudulent transfers, regardless of the nomenclature of the cause-of-action. *See In re AP Indus., Inc.*, 117 B.R. at 801; *Stahl*, 443 B.R. at 314, *aff'd Stahl* Summary Order. The Third Party Plaintiffs' attempts to label certain of the relief they seek as damages does not assist them because one cannot attempt to disguise an attempt to recover the proceeds of fraudulent transfers by claiming to seek money damages. *See id.*

C. The Third Party Plaintiffs Seek to Collect or Recover on the Trustee's Claims in Violation of Section 362(a)(6)

The Third-Party Plaintiffs' attempt to recover (or recover from) the proceeds of fraudulent transfers held by the Chais Defendants is likewise foreclosed by section 362(a)(6), which prohibits acts to collect or recover a claim against the debtor. To the extent the Third Party Actions seek to collect out of the property that the Trustee is pursuing in his fraudulent transfer claims, they violate section 362(a)(6) because they "prejudic[e] the Trustee's ability to

litigate a competing avoidance claim on behalf of all creditors and [is] therefore inconsistent with the basic purpose of the automatic stay." *Sosne v. Reinert & Duree, P.C. (In re Just Brakes Corporate Sys., Inc.)*, 108 F.3d 881 (8th Cir. 1997); *see also* COLLIER ON BANKRUPTCY ¶ 362.03(8)(c) (Alan A. Resnick & Henry J. Somme eds., 16th ed. (2010) ("The stay does apply, however, to an attempt to collect a prepetition claim out of property that was fraudulently transferred by the debtor before the commencement of the case" although the property is not itself property of the estate); *see* also Cole Decl. Ex. N (transcript of District Court hearing in *Stahl*) at 33:8-19 (in affirming *Stahl* decision, finding *Just Brakes* "the closest case that I found, and which I believe is persuasive . . . ").

As discussed above, the Third Party Plaintiffs essentially concede in their complaints that the losses they suffered were the loss of funds that were invested into BLMIS, and the damages that they seek to recover from the Chais Defendants consist of funds that were wrongly transferred from BLMIS to the Chais Defendants. (*See, e.g.*, Cole Decl. Ex. F ¶ 21 ("Unbeknownst to the Sub-Partners, the Partnerships, in turn invested all of their capital with BMIS. Accordingly, Plaintiff believes that all of the Sub-Partnerships' assets have been lost."); *id.* ¶ 24 ("The Chais Revenue consisted of fees subtracted from the purported profits of the Partnerships' limited partners such as the Sub-Partnerships. These fees were a significant proportion of the purported profits."); *id.* ¶ 25 ("Chais distributed part or all of the Chais Revenue to Chais-Related Individuals and Chais Entities."); *id*. Ex. I (Fourth Amended Complaint) ¶ 68(c) ("Chais relinquished control of all the partnerships' assets to BLMIS . . . "); *id.* ¶ 95 ("The Chais Family Trusts made numerous transfers of cash from their accounts at BLMIS to the trusts' beneficiaries for the purpose of hindering, delaying and defrauding creditors."); *id*. Ex. J ¶ 2 ("Brighton, Lambeth and Popham were all or substantially all given

over to Madoff."); *id.* ¶ 17 ("Chais gave all or substantially all of the Chais Funds' assets to Madoff.")).

The Third Party Plaintiffs further appear to acknowledge that the recoveries that they are seeking constitute funds derived from the BLMIS Ponzi scheme. (*See, e.g.*, Cole Decl. Ex. F ¶ 94 ("In exchange, Chais derived large sums in the guise of fees. Furthermore, Chais, the Chais-Related Individuals, the Chais entities, and the Chais Trusts benefitted from the distribution and receipt of hundreds of millions of dollars from so-called fees based on the fictitious profits of the Partnerships purportedly derived from their investment in B[L]MIS."); *id.* ¶ 174 ("Under these circumstances, the Chais Estate had been unjustly enriched and, in equity and good conscience, the Chais Estate should be made to return the unjustly gained monies"); *id.* ¶ 175 ("Accordingly, the Chais Estate thus holds its assets as constructive trustee for the benefit of the creditors of the Chais Estate including the limited partners of the Partnerships."); *id.* Ex. I (Fourth Amended Complaint) ¶ 62 ("Chais led [ ] investors to believe that he was actively managing their investments and extracted fees equal to 25% of annual profits for his services."); *id.* ¶ 89 ("Chais received a 25% management fee in all years when the Lambeth and Brighton partnerships earned greater than a 10% return."); *id.* ¶ 90 ("Chais's estate would be unjustly enriched at the expense of all partners of Lambeth and Brighton if permitted to retain these fees. Under these circumstances, equity and good conscience mandate that the Chais estate return the unjustly gained monies to Lambeth and Brighton. Any judgment entered on this cause of action should include the Trustees as parties liable for the damages because there is such a unity of interest and control by Chais over the Trustees that to recognize the existence of the Chais Family Trusts and the Trustees as separate and distinct from Chais would sanction a fraud and promote injustice.");

id. Ex. J at 15 (seeking "full restitution of any money or other property" and "disgorge[ment of] all profits and compensation" obtained by Chais in violation of California state law)).[29]

The Third Party Plaintiffs' attempt to recover, or recover from, the proceeds of fraudulent transfers received by the Chais Defendants is an improper attempt to collect on the Trustee's claims against these defendants and is thus precluded by section 362(a)(6).

D. The Third Party Actions Seek to Obtain Customer Property in violation of Section 362(a)(3)

As defined above, under section 78*lll*(4) of SIPA, "customer property" is defined as "cash and securities . . . at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted." In this Ponzi scheme case, where all assets that were transferred were the property of other customers, ownership in such property can never be attributed to the debtor. All property was "unlawfully converted" by BLMIS and is, by definition, customer property.[30] In addition, to the extent BLMIS transferred any property to a third party as "proceeds," such property is customer property. SIPA § 78*lll*(4). As such, the customer property retained its character, notwithstanding the transfer to the Chais Defendants.[31]

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[29] The Third Party Plaintiffs' attempts to label certain of the relief they seek as "damages" changes nothing. One cannot attempt to disguise an attempt to recover the proceeds of fraudulent transfers by claiming to seek money damages. *In re AP Indus., Inc.*, 117 B.R. at 801.

[30] The fact that Madoff unlawfully converted all of BLMIS's customers' property is indisputable. *See* Plea Hearing Transcript, *United States v. Madoff*, Case No. 09-CR-213(DC) (S.D.N.Y. Mar. 12, 2010); *see also In re Klein, Maus & Shire, Inc.*, 301 B.R. 408, 420 (Bankr. S.D.N.Y. 2003) (unlawful conversion includes misappropriation and misuse of customer property by the debtor).

[31] Section 78fff-2(c)(3) of SIPA became operative when the United States District Court for the Southern District of New York entered a protective order pursuant to SIPA § 78eee(b)(1) decreeing that the customers of BLMIS were in need of the protection afforded by SIPA. From that date, it was abundantly clear that there was insufficient customer property to pay all the claims in full, and therefore the Trustee began to seek recovery of all customer property wherever it may lie. As of such date, therefore, section 78fff-2(c)(3) deems transferred customer property to be the property of BLMIS.

Actions that have the effect of exercising control over property of the estate or customer property, or where the actions "necessarily implicate" a debtor's property interests, violate Bankruptcy Code § 362(a)(3), regardless of whether the debtor is named in the action. *Adelphia*, 2006 WL 1529357, at *3 (granting TRO because third-party suit threatened to interfere with debtor's realization of value of its assets and its reorganization); *In re MCEG Prods., Inc.*, 133 B.R. 232, 235 (Bankr. C.D. Cal. 1991). Indeed, section 362(a)(3) protects the *in rem* jurisdiction of the Court, and prohibits interference with the disposition of the assets that are under the Court's wing, whether or not the debtor is named as a defendant as part of that effort. And this is so regardless of the form the interference takes. *Adelphia*, 2006 WL 1529357, at *3. Critically, courts look to the substance and not the form of the purported action. *See 48th Street Steakhouse, Inc. v. Rockefeller Group, Inc.* (*In re 48th Street Steakhouse, Inc.*), 835 F.2d 427, 431 (2d Cir. 1987) ("If action taken against the non-bankrupt party would inevitably have an adverse impact on property of the bankrupt estate, then such action should be barred by the automatic stay.").

The Third Party Plaintiffs seek to recover from the pool of customer property that was improperly transferred to the Chais Defendants—funds that the Trustee seeks to recover in connection with his lawsuit against the Chais Defendants. The Third Party Actions will "inevitably have an adverse impact on the property of the estate," *48th Street Steakhouse*, 835 F.2d at 431, and constitute a clear violation of the automatic stay. If the Third Party Plaintiffs succeed in their actions and obtain judgments against the Chais Defendants, they will be obtaining potential estate assets. Even presuming that the Third Party Plaintiffs will not be successful in their actions, their continued prosecution will deplete assets otherwise potentially recoverable by the Trustee as customer property. (Cole Decl. Ex. N (transcript of District Court

hearing in *Stahl*) at 36:11-12 ("continuing these [third-party] lawsuits at enormous expense is a waste of personal assets that the trustee seeks to recover . . . .").) Finally, the Third-Party Plaintiffs' interference with the Trustee's prosecution of his avoidance causes of action against the Chais Defendants—claims that are property of the estate, *see Jackson v. Novak (In re Jackson)*, 593 F.3d 171, 176 (2d Cir.2010)—likewise violates section 362(a)(3).

E. The CAAG Action Is Not Exempt from the Automatic Stay and the Stay Orders

Section 362(b)(4) of the Bankruptcy Code provides that the filing of a bankruptcy proceeding does not operate as a stay against "the commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a monetary judgment, obtained in an action" by the governmental unit to enforce its police or regulatory power. 11 U.S.C. § 362(b)(4). This section was intended to "be given a narrow construction" to permit the government to "pursue action to protect the public health and safety" but not to apply to government actions brought "to protect a pecuniary interest in property of the debtor or property of the estate." *In re Chateaugay Corp.*, 115 B.R. 28, 32 (Bankr. S.D.N.Y. 1988) (citing legislative history) (emphasis in original removed). The exception therefore applies if the purpose of the law sought to be enforced by the government action is to "promote 'public safety and welfare' or to effectuate public policy." *Enron Corp. v. California (In re Enron Corp.)*, 314 B.R. 524, 535 (Bankr. S.D.N.Y. 2004) (citation omitted). If, however, the purpose of the law "relates to the protection of the government's pecuniary interest in the debtor's property," or to adjudicate private rights, the exception is inapplicable and the automatic stay applies." *Id*. (citation omitted).

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

The same result is mandated here. The CAAG Action has been brought for the primary purpose of obtaining restitution, disgorgement and civil penalties. (Cole Decl. Ex. J at 2, 15-16.) As in *Enron*, the CAAG is acting on behalf of certain private litigants, and is therefore subject to the automatic stay.[32] In any event, even if the CAAG Action were a "proper exercise of the police power, the collection of a money judgment is barred by the stay and can only occur (if at

[32] One district court in the Eastern District of New York has broadened the exception to the stay by applying a "pecuniary advantage" test, under which the relevant inquiry is "whether the specific acts that the government wishes to carry out would create a pecuniary advantage for the government vis-à-vis other creditors." *Fullington v. Parkway Hosp.*, 351 B.R. 280, 283 (Bankr. E.D.N.Y. 2006). Even the more lenient "pecuniary advantage" test would be of no avail to the CAAG here, however, because regardless of the pecuniary interest of the State of California, the primary purpose of the CAAG Action is to adjudicate private rights. *Cf. Fullington*, 351 B.R. at 288-89 (section 362(b)(4) exception applied to Department of Justice action seeking restitution to the government for frauds committed upon national treasury). In any event, under any test and for any action, the exception to the automatic stay does not extend to the enforcement of a money judgment. *See, e.g., Fullington*, 351 B.R. at 286.

all) in the bankruptcy court . . . ." *In re Enron*, 314 B.R. at 534; *see* 11 U.S.C. § 362(b)(4) (providing exception to stay for enforcement of a judgment "other than a money judgment" obtained by a governmental unit enforcing its police and regulatory powers). Therefore, at a minimum, the CAAG should be enjoined from attempting to enforce any money judgment it obtains from the Chais Defendants. As stated herein, the Trustee does not seek to enjoin the CAAG from pursuing or obtaining injunctive and regulatory relief, which does not infringe on the Trustee's ability to recover and distribute customer property.

III. THE COURT SHOULD ENJOIN THE THIRD PARTY PLAINTIFFS PURSUANT TO SECTION 105(A) OF THE BANKRUPTCY CODE TO ALLOW FOR THE FAIR AND EQUITABLE ADMINISTRATION OF THE BLMIS ESTATE

This Court is empowered to extend the automatic stay to the Chais Defendants under section 105(a) of the Bankruptcy Code given, among other things, the adverse economic impact on the estate if the Third Party Actions are allowed to continue. *See, e.g., Picard v. Fox*, 429 B.R. at 435-36; *Stahl*, 443 B.R. at 316-19. Continued prosecution of the Third Party Actions will diminish the limited assets of the Chais Defendants, which assets constitute avoidable transfers and potential property of the estate, recoverable by the Trustee for distribution to defrauded investors. The Trustee, under the supervision of this Court, is engaged in a complex recovery effort with an extremely broad scope. A preliminary injunction is necessary to allow the Trustee to properly administer this process.

A. Standards for a Section 105(a) Injunction

Section 105(a) of the Bankruptcy Code, applicable here pursuant to section 78fff(b) of SIPA, bestows on bankruptcy courts broad discretion to "issue any order 'necessary or appropriate to carry out the provisions of [the Bankruptcy Code]' . . . ." 11 U.S.C. § 105(a). Courts in this Circuit have held that section 105(a) authorizes bankruptcy courts to issue injunctions and, when the court does so, the standard for Rule 7065 injunctions is inapplicable.

In re Probulk Inc., 407 B.R. 56, 63 (Bankr. S.D.N.Y. 2009). The Court may enjoin suits if (i) a third party suit would impair the court's jurisdiction with respect to a case before it or (ii) the third party suits threaten to thwart or frustrate the debtor's reorganization efforts and the stay is necessary to preserve or protect the debtor's estate.[33] *See In re Calpine Corp.*, 354 B.R. 45, 48 (Bankr. S.D.N.Y. 2006), *aff'd*, 365 B.R. 401 (S.D.N.Y. 2007); *In re Adelphia Commc'ns Corp*., 298 B.R. 49, 54 (S.D.N.Y. 2003) (internal citation omitted); *In re Lyondell Chem. Co.*, 402 B.R. 571, 588 n.37 (Bankr. S.D.N.Y. 2009); *In re Keene Corp.*, 162 B.R. 935, 944 (Bankr. S.D.N.Y. 1994); *In re Ionosphere Clubs, Inc*., 111 B.R. 423, 431 (Bankr. S.D.N.Y. 1990), *aff'd in part*, 124 B.R. 635 (S.D.N.Y. 1991); *Garrity v. Leffler* (*In re Neuman*), 71 B.R. 567, 571–72 (S.D.N.Y. 1987); *C & J Clark Am., Inc. v. Carol Ruth, Inc.* (*In re Wingspread Corp.*), 92 B.R. 87, 92 (Bankr. S.D.N.Y. 1988); *LTV Steel Co., Inc. v. Bd. of Educ*. (*In re Chateaugay Corp*.), 93 B.R. 26, 29 (S.D.N.Y. 1988); *Fisher v. Apostolou*, 155 F.3d 876, 882 (7th Cir. 1998).

Courts have routinely used section 105(a) to extend section 362 to third-party actions against non-debtor entities "when a claim against the non-debtor will have an immediate adverse economic consequence for the debtor's estate." *Picard v. Fox*, 429 B.R. at 434 (*quoting Queenie, Ltd. v. Nygard Int'l*, 321 F.3d 282, 287 (2d Cir. 2003)). For example, the District Court, in affirming a bankruptcy court decision enjoining certain third party litigation, held that an injunction was properly granted pursuant to section 105(a) and the court accordingly did not need to consider whether section 362 was also applicable. The court noted:

[33] Notwithstanding that the Rule 7065 standard need not be satisfied here, it easily is. There is no question that an infringement on this Court's jurisdiction constitutes "irreparable harm." *Adelphia*, 2006 WL 1529357, at *5. Moreover, the Trustee is likely to succeed on the merits of his complaint and demonstrate that the Third Party Plaintiffs have violated the automatic stay, as demonstrated herein. *See id.* at *4–5; *see Picard v. Fox*, 429 B.R. at 436 n.14; *Stahl*, 443 B.R. at 318 n.24.

> Courts have consistently found that section 105 may be used to stay actions against non-debtors even where section 362 otherwise would not provide such relief, recognizing that section 105 grants broader authority than section 362.

Nevada Power Co. v. Calpine Corp. (*In re Calpine Corp.*), 365 B.R. 401, 409, n.20 (S.D.N.Y. 2007); *see also In re Lyondell Chemical Co.*, 402 B.R. 571 (Bankr. S.D.N.Y. 2009) (court, in granting a limited injunction to stay non-debtor litigation, noted that section 105(a) could be used to enjoin acts against non-debtor entities even when section 362 protection was not available); *C & J Clark America Inc. v. Carol Ruth, Inc.* (*In re Wingspread Corp.*), 92 B.R. 87, 94 (Bankr. S.D.N.Y. 1988) (the basic purpose of section 105(a) is to enable the court to do whatever is necessary to aid its jurisdiction); *Garrity v. Leffler* (*In re Neuman*), 71 B.R. 567, 571 (S.D.N.Y. 1987) (under section 105 the bankruptcy court has broad powers to issue injunctions notwithstanding the inapplicability of the automatic stay provisions).

B. The Third Party Actions Threaten the Court's Jurisdiction and the Administration of the Estate and an Injunction is Necessary to Preserve and Protect the Estate

As described above, the Third Party Actions target potential property of the estate that is the subject of a claims administration and asset recovery process of unprecedented magnitude. Any attempt by the Third Party Plaintiffs to leapfrog over other Madoff fraud victims harms not only those victims, but the orderly administration of the estate. Such an outcome would not only compromise the equitable distribution of customer property through the estate, a process sanctioned by this Court in its Net Equity Decision, affirmed by the Second Circuit (*see In re Bernard L. Madoff Sec., LLC*, 424 B.R. 122, *aff'd* 654 F.3d 229 (2d Cir. 2011)), but would run afoul of the general principle that creditors of a bankruptcy estate should not be permitted to race to the courthouse to recover preferentially to other creditors. *See, e.g., In re Keene Corp.*, 164 B.R. at 849-54; *In re AP Indus., Inc.* 117 B.R. at 799; *In re Johns-Manville Corp.*, 91 B.R. 225, 228-29 (Bankr. S.D.N.Y. 1988); *In re 1031 Tax Group, LLC*, 397 B.R. 670, 686 (Bankr.

S.D.N.Y. 2008). It would also frustrate the goals of SIPA, which seeks to return to each customer, on an equal basis, his or her net equity in the debtor. *See Fox*, 429 B.R. at 427 ("The statutory framework for the satisfaction of customer claims in a SIPA liquidation proceeding provides that customers share *pro rata* in customer property to the extent of their net equities . . ."); *Stahl*, 443 B.R. at 301, *aff'd Stahl* Summary Order.

The Third Party Plaintiffs' conduct is just the sort of behavior courts in this and other jurisdictions have prohibited time after time. *See, e.g.*, *In re Keene Corp.*, 164 B.R. at 849, 854; *In re AP Indus., Inc.*, 117 B.R. at 801–802; *In re Johns-Manville Corp.*, 91 B.R. at 228; *In re 1031 Tax Group, LLC*, 397 B.R. at 684–85; *In re Singer Co. N.V.*, 2000 WL 33716976 at *5–7 (Bankr. S.D.N.Y. Nov. 3, 2000); *Apostolou*, 155 F.3d 876; *Baldwin-United Corp. v. Paine Webber Group, Inc.* (*In re Baldwin-United Corp.*), 57 B.R. 759 (S.D. Ohio 1985).

And this Court already has twice held that a section 105(a) injunction was necessary to protect the court's jurisdiction and the administration of the liquidation. In *Picard v. Fox* and *Picard v. Stahl*, this Court granted the Trustee's application for a preliminary injunction, enjoining the defendants therein from prosecuting actions against parties being sued by the Trustee. In addition to finding that the Third Party Plaintiffs in those actions had usurped causes of actions belonging to the Trustee, the Court found that the Third Party Actions at issue in those cases would have "an immediate adverse economic consequence for the debtor's estate." *Stahl*, 443 B.R. at 316 (*quoting Queenie*, 321 F.3d at 287). While the Third Party Plaintiffs here may have some independent claims against the Chais Defendants, nevertheless, just as in *Fox* and *Stahl*:

> Both the Trustee and the [Third Party Plaintiffs] target the same limited pool of funds originating with BLMIS . . . . The [Third Party Plaintiffs' actions] thus threaten the Trustee's ability to collect on any judgment that may be awarded in

> connection with his pending adversary proceeding, to the detriment of the BLMIS estate.

Fox, 429 B.R. at 435; *see also Stahl*, 443 B.R. at 317. In affirming the *Stahl* decision, the District Court found that the third-party actions at issue in that action "substantially interfere[d] with the ability of the trustee to move in his cases to recover assets for the estate as a whole," and had an adverse impact on property of the estate because the money recovered by the third-party plaintiffs in any judgment "would inevitably be the money that the trustee sought to recover." (*See* Cole Decl. Ex. N (transcript of District Court hearing in *Stahl*) at 29:9-16, 32:5-10.) The District Court found:

> And rather than have a profusion of claims, it's the rationale behind Section 362 and Section 105 to favor the trustee. It doesn't have to be for all time, but it has to allow the trustee the ability to pursue his actions and obtain rulings and finality on those rulings because the trustee is acting for the benefit of all creditors and not just a few.

(*Id.* at 31:16-21.) The District Court further held that "continuing [the third-party plaintiffs'] lawsuits at enormous expense is a waste of personal assets that the trustee seeks to recover," and that "more persuasively to me than anything else, the profusion of lawsuits makes it extremely difficult for the trustee to run his lawsuit expeditiously and economically in the interests of the creditors of the estate." (*Id.* at 36:11-16.) Like the third-party actions in *Stahl*, the Third Party Actions hinder the Trustee's prosecution of his action against the Chais defendants for the benefit of all creditors, and should likewise be enjoined pursuant to section 105(a).

As this Court discussed in *Fox* and *Stahl*, and as the District Court discussed in its ruling affirming *Stahl*, the Seventh Circuit in *Fisher v. Apostolou*, 155 F.3d 876 (7th Cir. 1998), faced with a similar scenario, also found the use of a section 105(a) injunction appropriate. *See Picard v. Fox*, 429 B.R. at 434-35; *Stahl*, 443 B.R. at 316-17; *see also* Cole Decl. Ex. N (transcript of District Court hearing in *Stahl*) at 34:15-21 (finding *Apostolou* "instructive"). In *Apostolou*,

which was a liquidation proceeding, the Seventh Circuit upheld the bankruptcy court's issuance of an injunction under § 105(a) to protect the trustee's ability to marshal assets on behalf of the debtor's estate, even when the enjoined action did not directly seek property of the debtor's estate. *Apostolou*, 155 F.3d at 877–88. The bankruptcy court issued an injunction pursuant to section 105(a), which the district court reversed. The Seventh Circuit reversed the district court's determination that the bankruptcy court had exceeded its authority in issuing the injunction, stating that:

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

Id. at 882. Notably, the Seventh Circuit acknowledged that, like the Third Party Plaintiffs here, some of the plaintiffs in *Apostolou* may have had claims against the defendants based on a "separate and distinct injury" to the individual plaintiff that could not be fully measured by the debts owed to the estate. *Id.* at 881. The court nevertheless held that the investors who were the plaintiffs in those actions "must wait their turn behind the trustee, who has the responsibility to recover assets of the estate on behalf of creditors as a whole . . . ." *Id.* Accordingly, the court stayed the underlying actions pending the outcome of the bankruptcy proceeding: "At that point, the degree to which the Apostolou Plaintiffs have been compensated for their injuries through their share of the assets in the debtor's estate will be settled, and it will be possible for the district court to proceed with this action against the nondebtor defendants for whatever individualized damages may be proper." *Id.* at 883.

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

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

Id. at 802; *see also In re Singer Co. N.V.*, 2000 WL 33716976 at *7. Akin to the claims the debtor's investors asserted in *Fox, Apostolou, AP Industries,* and *Stahl*, allowing the Third Party Plaintiffs to continue to prosecute their claims will impair this Court's jurisdiction over this proceeding and the Trustee's ability to marshal assets on behalf of the estate. (*See* Cole Decl. Ex. N (transcript of District Court hearing in *Stahl*) at 36:12-16 ("And, more persuasively to me than anything else, the profusion of lawsuits makes it extremely difficult for the trustee to run his lawsuit expeditiously and economically in the interests of the creditors of the estate.").)

Moreover, allowing the Third Party Actions to continue could create confusion among other BLMIS investors and creditors who will feel compelled to initiate their own self-help proceedings and which could create a "race to the courthouse" environment, threatening the orderly administration of the estate. The statutory schemes created by SIPA and the Bankruptcy Code are specifically aimed at trying to avoid such a result. *See Sec. Investor Prot. Corp. v. Blinder, Robinson & Co., Inc.*, 962 F.2d 960, 965 (10th Cir. 1992) (quoting H.R. REP. NO. 1613, 91st Cong. 2d Sess. (1970) *reprinted in* 1970 U.S.C.C.A.N. 5254, 5262: SIPA "establishes

procedures for the prompt and orderly liquidation of SIPC members . . ."); *see also In re Shea & Gould*, 214 B.R. 739, 750 (Bankr. S.D.N.Y. 1997) (Bankruptcy Code seeks to prevent "race to the courthouse"); *In re Rubin*, 160 B.R. 269, 281 (Bankr. S.D.N.Y. 1993) (same); *In re Russo*, 18 B.R. 257, 265 (Bankr. E.D.N.Y. 1982) (same).

An injunction will also avoid the possibility of inconsistent decisions, ensuring uniformity of decision, and will allow the Trustee to avoid appearing in the Third Party Actions, incurring needless litigation costs and distracting from the operation of a very complex liquidation proceeding. Principles of judicial economy further support the Trustee's request for a preliminary injunction. *See, e.g.*, *City of New York v. Exxon Corp.*, 932 F.2d 1020, 1026 (2d Cir. 1991) (relying on principles of judicial economy to enjoin plaintiff from pursuing a similar action in bankruptcy court). Instead of having a court in another jurisdiction consider these issues, this Court, which is already familiar with the relevant facts, can most expeditiously resolve the issues relating to customer property.

C. The Third Party Actions Threaten to Undermine the Claims Administration Process

This Court already has approved a claims administration process and determined how customers' and other creditors' claims are to be valued and administered. As described above, this Court instituted the Claims Procedures Order, which sets forth a framework for the filing, determination and adjudication of claims. *In re Bernard L. Madoff Sec., LLC*, 424 B.R. 122.

Essentially, the Third Party Actions are attempts by Third Party Plaintiffs Hall, Heimoff, and the CAAG to satisfy claims relating to their investments (or, in the CAAG's case, investments of the parties the CAAG purports to represent) in BLMIS feeder funds by circumventing the claims determination and allowance process, of which they are direct or indirect participants, and to take for themselves funds that otherwise would be recoverable by the

Trustee and equitably distributed to customers and creditors of BLMIS in accordance with this Court's Net Equity Decision and the Net Equity Order. *In re Bernard L. Madoff Sec., LLC*, 424 B.R. 122; Adv. Pro. No. 08-01789, ECF No. 2020.)

In sum, the Third Party Actions all seek to tap into the same pool of money as the Trustee and constitute an attempt by feeder fund investors to cut ahead of other creditors to obtain a greater share of customer property than they would otherwise receive. The continued prosecution of the Third Party Actions is detrimental to the equitable distribution of customer property mandated by SIPA and this Court.

D. The Trustee Would Pursue Any Transfers of Customer Property From the Chais Defendants to the Third Party Plaintiffs

As further grounds for the requested relief, the Trustee seeks an injunction to avoid unnecessary proceedings in connection with property that is under this Court's jurisdiction. In the event that any of the Third Party Plaintiffs were to recover customer property from the Chais Defendants through the Third Party Actions, the Trustee would then seek to avoid the transfer of such funds on the grounds that the Third Party Plaintiffs, as subsequent transferees, took without value and with knowledge of the voidability of the transfers. *See* 11 U.S.C. §§ 548, 549, 550.

Accordingly, the Court should preliminarily enjoin the Third Party Plaintiffs from litigating against the Chais Defendants, pending the completion of the Trustee's Chais Action.

CONCLUSION

The Trustee respectfully requests that the Court: (i) declare that the Third Party Actions violate the Stay Orders, section 78eee(b)(2)(B) of SIPA and the automatic stay and are void *ab initio* with respect to the Chais Defendants; and (ii) issue an injunction prohibiting the Third Party Plaintiffs from pursuing the Third Party Actions, as against the Chais Defendants, or any

other actions as against the Chais Defendants, and from pursuing discovery from the Trustee, until such time as the Trustee has completed his action against the Chais Defendants.

Dated: New York, New York
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/s/ Marc E. Hirschfield

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