11-5044-BK

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

IN RE: BERNARD L. MADOFF INVESTMENT SECURITIES LLC.,

IRVING H. PICARD,

Plaintiff-Appellant,

v.

JPMORGAN CHASE & CO., JPMORGAN CHASE BANK, N.A.,
J.P. MORGAN SECURITIES LLC, J.P. MORGAN SECURITIES LTD.,

Defendants-Appellees,

and

SECURITIES INVESTOR PROTECTION CORPORATION,

Intervenor.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF FOR DEFENDANTS-APPELLEES

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1(a), defendant-appellee JPMorgan Chase & Co. states that it is a publicly held company and has no parent corporation.

Defendant-appellee JPMorgan Chase Bank, N.A. states that it is a private non-governmental party, and JPMorgan Chase & Co. owns, directly or indirectly, 10% or more of the stock of JPMorgan Chase Bank, N.A.

Defendant-appellee J.P. Morgan Securities LLC states that it is a private non-governmental party, and JPMorgan Chase & Co. owns, directly or indirectly, 10% or more of the stock of J.P. Morgan Securities LLC.

Defendant-appellee J.P. Morgan Securities Ltd. states that it is a private non-governmental party, and JPMorgan Chase & Co. owns, directly or indirectly, 10% or more of the stock of J.P. Morgan Securities Ltd.

PRELIMINARY STATEMENT

The district court faithfully applied two well-established rules of standing in dismissing the common law claims brought by the Trustee for Bernard Madoff's disgraced brokerage firm. First, as the United States Supreme Court and this Court have held, "a bankruptcy trustee has no standing generally to sue third parties on behalf of the estate's creditors, but may only assert claims held by the bankrupt corporation itself." *Shearson Lehman Hutton, Inc.* v. *Wagoner*, 944 F.2d 114, 118 (2d Cir. 1991) (citing *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972)). Second, as this Court has held, a bankruptcy trustee also lacks standing to sue third parties on behalf of the bankrupt corporation where the debtor itself participated in defrauding creditors. *Id*. at 120.

Based on these settled rules, the district court correctly held that the Trustee has no authority to bring common law damages claims against JPMorgan. Finding "no doubt" that the Trustee's common law claims "belong" only to Madoff's defrauded investors, the court held that the Trustee — as successor to Madoff's brokerage firm — lacks standing to pursue those claims. SPA-7. The district court further held that even if those common law claims are deemed to belong to Madoff's brokerage firm, the Trustee would still be barred from pursuing them in light of the brokerage firm's criminal fraud. SPA-8.

In reaching this result, the district court echoed the Supreme Court's sound reasoning in *Caplin*. In that case, the Supreme Court held that nothing in federal bankruptcy law authorizes a trustee to aggregate and assert creditor claims. 406 U.S. at 428; SPA-7. The Supreme Court reasoned that permitting a trustee to usurp creditor claims would create a morass of legal and practical problems: it would not only strip creditors of control over their own claims, but also invite duplicative lawsuits to redress the same harms. 406 U.S. at 431-32; SPA-7.

In seeking to justify his pursuit of common law claims in the face of *Caplin* and *Wagoner*, the Trustee has changed course repeatedly, putting forward a shifting array of arguments. In the district court, the Trustee's lead argument was that section 544(a) of the Bankruptcy Code, under which a trustee has the rights of a hypothetical lien creditor, authorizes trustees to assert creditor damages claims. The district court thoroughly refuted this argument, SPA-9-17, and the Trustee has summarily abandoned it on appeal, Trustee Br. 7 n.4.

The Trustee's remaining arguments are no more persuasive. The Trustee invokes this Court's decision in *St. Paul Fire & Marine Insurance Co*. v. *PepsiCo, Inc.*, 884 F.2d 688 (2d Cir. 1989), which held that a bankruptcy trustee could pursue a veil-piercing claim against the bankrupt company's parent. What the Trustee overlooks, however, is that the veil-piercing claim in *St. Paul* belonged solely to *the debtor*; creditors lacked standing to pursue the claim. *Id*. at 703-05.

St. Paul thus did not depart from the bedrock rule that a bankruptcy trustee lacks standing to pursue creditor claims — a rule that this Court has since applied repeatedly in dismissing claims brought by trustees. *E.g.*, *The Mediators, Inc.* v. *Manney (In re Mediators, Inc.)*, 105 F.3d 822 (2d Cir. 1997); *Hirsch* v. *Arthur Andersen & Co.*, 72 F.3d 1085 (2d Cir. 1995).

The Trustee also contends that under the Securities Investor Protection Act of 1970 (SIPA), he has broader powers than an ordinary bankruptcy trustee and can assert customer claims against third parties either as a "bailee" of customer property or as a "subrogee" of customer claims. As the district court held, however, the Trustee has no possible bailment rights as successor to Madoff's brokerage firm because "a thief can never take the status of a bailee." SPA-30. Moreover, as the district court held, it would be "fanciful" to read SIPA as creating *new* bailment rights in favor of the Trustee: the statute "does not create or contemplate a bailment relationship." SPA-30-31.

The Trustee's subrogation theory fares no better. According to the Trustee, after paying all or a portion of customers' statutory "net equity" claims against the estate, as required by SIPA, the Securities Investor Protection Corporation (SIPC) becomes subrogated to any tort claims customers may have against third parties, and SIPC can then assign such subrogation rights to the Trustee. SIPA establishes a comprehensive system designed by Congress to

expedite the satisfaction of "net equity" claims filed by customers of failed brokerage firms. As part of that system, SIPA provides SIPC with subrogation rights *only* with respect to customer "net equity" claims against the debtor's estate — it confers *no* such rights as to any claims against third parties. SPA-23-24. In addition, under this Court's precedent, the Trustee's subrogation claims also fail because the Trustee has provided no individualized information about the supposed subrogors or their alleged claims. *See Blue Cross & Blue Shield of New Jersey, Inc.* v. *Philip Morris USA Inc.*, 344 F.3d 211, 217-18 (2d Cir. 2003).

The Trustee's assertion that he can seek contribution from JPMorgan for his payments to customers is equally baseless. Since SIPA is the source of the Trustee's obligation to pay customers, the Trustee must look to federal law for any contribution rights. But SIPA confers no contribution rights. And in any event, under New York law, a contribution claim is available only when a joint tortfeasor is compelled to pay more than its fair share of tort liability; here, however, it is the SIPA statute — not state tort law — that compels the Trustee to pay customers. SPA-18-22.

In urging reversal, the Trustee relies heavily on *Redington* v. *Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978), *rev'd*, 442 U.S. 560 (1979), in which this Court: (1) first held that a broker-dealer's customers had an implied private right of action under section 17(a) of the Securities Exchange Act; and (2) then found

that a SIPA trustee as a "bailee," and SIPC as a "subrogee," had the power to assert that implied right of action. The Supreme Court, however, reversed this Court's decision to imply a private right of action. As the district court held, the Supreme Court's reversal on the threshold question of whether a section 17(a) claim existed means that this Court's secondary conclusion regarding who could assert that non-existent claim was "superfluous" and "cannot bind a lower court." SPA-28-29.

But even if *Redington* were good law, it does not control here. *Redington* did not involve a broker that stole from its customers. Accordingly, this Court had no occasion to apply either the rule that a thief is not a bailee or *in pari delicto* principles — both of which prevent the Trustee from asserting bailment rights in this case. In *Redington*, moreover, this Court expressly limited its standing analysis to the section 17(a) claim. *Redington* did not hold that a SIPA trustee can assert customer common law claims as a bailee or subrogee, and this Court has never so held.

Having properly dismissed the Trustee's claims for lack of standing, the district court did not consider JPMorgan's additional arguments for dismissal. But the Securities Litigation Uniform Standards Act provides an alternative ground for affirming the district court's dismissal of the Trustee's claims. That federal statute requires dismissal of mass actions based on state law that allege securities fraud. This lawsuit — in which the Trustee seeks to aggregate and assert the

common law claims of thousands of customers who were defrauded by Madoff's securities scheme — is precisely the kind of mass state law securities fraud action that SLUSA was designed to preempt.

COUNTERSTATEMENT OF THE ISSUES PRESENTED

1. Whether the district court was correct in holding that the Trustee lacks standing to pursue common law damages claims against JPMorgan.

2. Whether the district court was correct in dismissing the Trustee's contribution claim.

3. Whether SLUSA precludes the Trustee from bringing state law securities fraud claims on behalf of thousands of Madoff customers.

COUNTERSTATEMENT OF FACTS*

A. JPMorgan's contacts with Madoff

JPMorgan Chase is one of the largest banks in the world. A-671(¶ 22). Bernard L. Madoff Investment Securities LLC (BMIS) had a checking account at JPMorgan Chase and predecessor banks since 1986. A-691, A-716(¶¶ 104, 199).

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* Throughout this brief, "JPMorgan" refers to the four defendants: JPMorgan Chase & Co., JPMorgan Chase Bank, N.A., J.P. Morgan Securities LLC and J.P. Morgan Securities Ltd. "JPMorgan Chase" refers to JPMorgan Chase Bank, N.A.

During the six-year period prior to BMIS's bankruptcy, JPMorgan Chase received approximately $590,000 in fees from BMIS for banking services. A-747, A-810-12(¶ 306 & Ex. A). JPMorgan Chase also received interest payments of approximately $3.5 million on $145 million in loans to BMIS that BMIS repaid. A-741, A-810-12(¶ 288 & Ex. A).

Beginning in 2006, J.P. Morgan Securities Ltd. invested more than $300 million in four Madoff "feeder funds," *i.e.*, investment funds that invested with BMIS. These investments served as hedges for financial products under which JPMorgan's payments to sophisticated investors in Europe were tied to the feeder funds' returns. A-698, A-705-06, A-710(¶¶ 131, 160, 178).

After JPMorgan acquired Bear Stearns, JPMorgan conducted a review of its exposure to hedge funds. A-698(¶ 130). That review resulted in significant redemptions from hedge funds, including redemptions of approximately $276 million from Madoff feeder funds. A-710, A-929(¶ 178 & Ex. E).

B. Madoff's securities fraud

On December 11, 2008, the FBI arrested Bernard Madoff, and the U.S. Attorney for the Southern District of New York charged him with securities fraud. A-680(¶ 53). On March 12, 2009, Madoff pleaded guilty to securities fraud and admitted that he operated a Ponzi scheme through BMIS. A-681(¶ 58).

Madoff was the founder, chairman, chief executive officer and sole owner of BMIS, which he personally operated for decades as a Ponzi scheme. A-674, A-677, A-678(¶¶ 36, 44, 46). The Trustee has represented to the Bankruptcy Court that BMIS and Bernard Madoff were "alter ego[s]" and, on that basis, procured the substantive consolidation of the BMIS bankruptcy proceeding with Madoff's personal bankruptcy. A-964.

C. The Trustee's lawsuit

On December 2, 2010, after taking document and deposition discovery from JPMorgan, the Trustee commenced this action. After withdrawal of the reference to the district court, the Trustee filed the Amended Complaint.

The first 20 causes of action in the Amended Complaint are avoidance claims under federal bankruptcy law. These causes of action, which are not at issue on this appeal, seek to recover alleged direct and indirect transfers to JPMorgan totaling approximately $425 million. A-752-75(¶¶ 328-489).

Causes of action 21 to 28 are common law claims seeking to recover *$19 billion*, apparently the full amount of customer losses resulting from Madoff's fraud. These causes of action include claims for aiding and abetting fraud, aiding and abetting breach of fiduciary duty, "knowing participation in a breach of trust," "fraud on the regulator," unjust enrichment, conversion, aiding and abetting conversion, and contribution. A-775-800(¶¶ 490-589).

On August 1, 2011, JPMorgan moved to dismiss the common law claims in the Amended Complaint and certain of the bankruptcy claims. A-930-31. JPMorgan moved to dismiss the Trustee's common law claims for lack of standing and based on SLUSA. In addition, JPMorgan moved to dismiss for failure to state a claim.

Although not the subject of this appeal, a word is in order regarding the Trustee's allegations, repeated at length in his appellate brief, that JPMorgan employees were complicit in Madoff's crimes. After years of investigation, including substantial pre-litigation discovery from JPMorgan under Federal Rule of Bankruptcy Procedure 2004, the Trustee has nothing to support this false accusation. He has nothing to show that anyone at JPMorgan had actual knowledge of Madoff's fraud or any motive to participate in it. And his basic thesis — namely, that JPMorgan employees deliberately joined in a doomed-to-fail Ponzi scheme simply to preserve routine banking income — is preposterous. The Amended Complaint is a massive overreach on the part of a Trustee who, in a search for deep pockets, has recklessly accused people at JPMorgan of participating in Madoff's crimes without factual support and without regard for the consequences of his public accusations.

D. The District Court's decision

On November 1, 2011, the district court granted JPMorgan's motion to dismiss the common law claims, holding that the Trustee lacks standing to bring damages claims against JPMorgan and has no valid claim for contribution. SPA-1-33. The district court relied in part on Judge Rakoff's decision in the *HSBC* case, which dismissed common law claims brought by the Trustee against HSBC, Unicredit and other defendants. *Picard* v. *HSBC Bank PLC*, 454 B.R. 25 (S.D.N.Y. 2011). As a result, the district court did not reach JPMorgan's arguments that the common law claims should be dismissed under SLUSA and for failure to state a claim. SPA-5.

Dismissal of the Trustee's claims for lack of standing does not prevent customers from bringing their own claims. Individual customers have already sued JPMorgan. *E.g.*, *MLSMK* v. *JP Morgan Chase & Co.*, 431 F. App'x 17 (2d Cir. 2011). Other customers have sought to bring class actions against the bank. *Shapiro* v. *JPMorgan Chase & Co.*, No. 11-CV-8331 (S.D.N.Y.); *Hill* v. *JPMorgan Chase & Co.*, No. 11-CV-7961 (S.D.N.Y.).

SUMMARY OF ARGUMENT

The district court's decision should be affirmed. Under the Supreme Court's decision in *Caplin*, as well as this Court's decisions in *Wagoner* and *Hirsch*, the Trustee lacks standing to bring claims on behalf of Madoff's

customers. Moreover, under *Wagoner*, the Trustee also lacks standing to bring claims on behalf of BMIS due to its fraudulent conduct. Point I, *infra*.

The Trustee and SIPC offer no sound basis to defy these settled rules. Neither the Trustee nor SIPC has authority to pursue customer claims against third parties as a "bailee" or a "subrogee." Points II & III, *infra*. The Trustee also has no valid contribution claim, because his compulsion to pay customers arises under SIPA, which creates no contribution rights. Point IV, *infra*.

Even assuming that the Trustee had standing to assert the common law claims of Madoff's customers, SLUSA requires the dismissal of those claims. That statute preempts state law mass actions alleging securities fraud, which is exactly what this case is. Point V, *infra*.

ARGUMENT

I. THE TRUSTEE LACKS STANDING TO BRING COMMON LAW DAMAGES CLAIMS AGAINST JPMORGAN.

The Trustee seeks to recover losses suffered by a group of BMIS's creditors, *i.e.*, customers. As the district court recognized, "there is no doubt that the common law causes of action in the Amended Complaint[] . . . belong to the creditors, not to BMIS." SPA-7. Thus, as the district court held, the Trustee lacks standing to bring those claims. *Id*.

A. Under *Caplin*, *Wagoner* and *Hirsch*, the Trustee has no authority to assert claims that belong to customers.

The Trustee's lack of standing to bring claims that belong to Madoff's customers is rooted in the Supreme Court's 1972 decision in *Caplin*. In that case, the Supreme Court rejected a bankruptcy trustee's argument that federal bankruptcy law "enables him to collect money" owed to creditors, ruling instead that the statute only permitted the trustee to recover funds "owed to the estate." 406 U.S. at 428. The Court found that, despite the extensive legislation governing reorganizations, "nowhere in the statutory scheme is there any suggestion that the trustee in reorganization is to assume the responsibility of suing third parties" on behalf of creditors. *Id*. at 428, 434 ("Congress has not yet indicated even a scintilla of an intention" to confer such standing).

The Supreme Court in *Caplin* further explained that creditors of a bankrupt company "are capable of deciding for themselves whether or not it is worthwhile to seek to recoup whatever losses they may have suffered by an action against" third parties. 406 U.S. at 431. Permitting a trustee to assert creditors' claims, the Court reasoned, would (1) deprive creditors of the opportunity to "make their own assessment of the respective advantages and disadvantages" of litigation; (2) create the risk that "a suit by [the trustee] on behalf of [creditors] may be inconsistent with any independent actions" brought by creditors; and (3) raise questions as to who would be "bound by any settlement." *Id.* at 431-32.

Accordingly, as the district court recognized, *Caplin* long ago established the rule that a bankruptcy trustee may pursue "only those claims that properly belonged to the debtor before it entered bankruptcy." SPA-6. As the district court also recognized, "[t]here is good reason for this rule" (SPA-7): under the Bankruptcy Code, a trustee succeeds only to the "legal or equitable interests of *the debtor*." 11 U.S.C. § 541(a)(1) (SPA-40) (emphasis added). Authorizing a trustee to assert creditors' claims, in violation of this statutory language, would "usurp the creditors' right to determine whether and in what forum to vindicate their legal injuries, and would raise difficult issues of preclusion." SPA-7.

This Court has strictly and consistently enforced the rule set forth in *Caplin*. In *Shearson Lehman Hutton, Inc.* v. *Wagoner*, this Court held, based on *Caplin*, that "a bankruptcy trustee has no standing generally to sue third parties on behalf of the estate's creditors." 944 F.2d at 118. Rather, "the trustee stands in the shoes of the debtors, and can only maintain those actions that the debtors could have brought prior to the bankruptcy proceedings." *Hirsch*, 72 F.3d at 1093; *Wornick* v. *Gaffney*, 544 F.3d 486, 490 (2d Cir. 2008) (same); *Pereira* v. *Farace*, 413 F.3d 330, 342 (2d Cir. 2005) (same); *The Mediators, Inc.* v. *Manney (In re Mediators, Inc.)*, 105 F.3d 822, 825-26 (2d Cir. 1997) (same). If a claim belongs to creditors under state law, those creditors "are exclusively entitled to pursue that

claim, and the bankruptcy trustee is precluded from doing so." *Hirsch*, 72 F.3d at 1093, 1094; *Mediators*, 105 F.3d at 826 (same).

Based on these principles, this Court in *Wagoner* held that a bankruptcy trustee had no standing to bring claims under New York law against a broker, Shearson Lehman, for aiding and abetting the fraudulent investment activity of the bankrupt debtor. 944 F.2d at 119-20. In *Wagoner*, the owner and president of the debtor sold notes to members of his church and misappropriated the proceeds, trading stocks in the name of the debtor through a Shearson account. *Id.* at 116. When the debtor filed for bankruptcy, its trustee sued Shearson for damages, alleging that Shearson aided the wrongdoer in his trading. *Id*. at 117. Dismissing the claims, this Court held that a bankruptcy trustee "has no power to assert a claim" if it is "not one belonging to the bankrupt estate." *Id*. at 118. The Court then ruled that, to the extent the trustee's "claim alleges money damages to the 'clients of [the debtor],' it belongs only to the creditors" under New York law "and the trustee has no standing to assert it." *Id*. at 119-20.

Likewise, in *Hirsch*, this Court held that a bankruptcy trustee had no standing to bring creditor claims against accounting firms that had provided services to the debtor, a real estate investment firm operated as a Ponzi scheme. The Court concluded that "Connecticut law has recognized the standing of creditors to maintain causes of action for negligence, breach of fiduciary duty, and

fraud in precisely these circumstances." 72 F.3d at 1093. As a result, "claims predicated upon the distribution of misleading [documents] to investors in [the debtor's] limited partnerships are the property of those investors, and may be asserted only by them and to the exclusion of" the trustee. *Id.* at 1094; *see also Mediators*, 105 F.3d at 826 (affirming dismissal of breach of fiduciary duty claim brought by bankruptcy estate representative that "belong[ed] to the creditors *qua* creditors" under New York law); *American Tissue, Inc.* v. *Donaldson, Lufkin & Jenrette Securities*, 351 F. Supp. 2d 79, 90 (S.D.N.Y. 2004) (Lynch, J.) ("Insofar as [the debtor] seeks to recover money owed to creditors, it lacks standing.").

Wagoner and *Hirsch* are completely controlling. As in those cases, the Trustee here is asserting common law claims, against a third-party service provider to a fraudulent investment firm, to recover losses suffered by the investors. The Trustee's aiding and abetting and "knowing participation" claims allege that JPMorgan caused $19 billion in losses to Madoff's customers by assisting Madoff in his fraud and breach of fiduciary duty. *See, e.g.*, A-779, A-783, A-787, A-799(¶¶ 506, 508, 520, 535, 583). The Trustee's conversion and unjust enrichment claims similarly allege that JPMorgan wrongfully took property that belonged to Madoff's customers. A-787, A-788, A-792(¶¶ 538, 543, 557). Accordingly, the Trustee's common law claims against JPMorgan are "concededly

the property of the creditors directly, and not the property of the debtor." SPA-17. As such, the Trustee lacks standing to bring those claims. SPA-33.

B. *St. Paul* does not permit the Trustee to assert claims that belong to customers.

The Trustee seeks to escape from this well-settled law by misstating the holding and reasoning of this Court's 1989 decision in *St. Paul Fire and Marine Insurance Co*. v. *PepsiCo, Inc*. That case simply allowed a trustee to bring a veil-piercing claim that belonged to the *debtor* under state law. As the district court correctly recognized, *St. Paul* did *not* hold that a trustee could bring damages claims belonging to *creditors*, as the Trustee is trying to do here. SPA-14-15.

In *St. Paul*, PepsiCo brought a complaint against Banner Industries alleging that Banner was an alter ego of Banner's subsidiary, Commercial Lovelace, and that Banner was therefore liable for Commercial Lovelace's diversion of assets from a former PepsiCo subsidiary, Lee Way, whose debts PepsiCo had guaranteed before Lee Way was sold to Commercial Lovelace. At the same time, the bankruptcy trustee for the successor to Commercial Lovelace brought his own lawsuit against Banner, alleging that "the same acts identified by PepsiCo as causing harm to Lee Way also caused harm to both the estate and the unsecured creditors, of whom PepsiCo [was] one." *St. Paul*, 884 F.2d at 695. The

question presented was whether PepsiCo had standing to bring a veil-piercing claim or, alternatively, whether the trustee alone had such standing. *Id*. at 696.

This Court framed the issue as follows: if PepsiCo's claims "are property of *the debtor*" under state law, "*and therefore properly brought by the trustee*, and if PepsiCo has not alleged a direct injury traceable to Banner," then PepsiCo would lack standing to assert those claims. *Id*. at 700 (emphasis added). The Court went on to conclude that, "under Ohio law, a corporation [here, Commercial Lovelace] would be able to assert an alter ego cause of action against its parent corporation [Banner]. The cause of action therefore becomes *property of the estate* of a bankrupt subsidiary, and is properly asserted by *the trustee* in bankruptcy." *Id.* at 703-04 (emphasis added). In contrast, the Court determined that individual creditors such as PepsiCo could *not* allege "the type of harm necessary to support a finding of standing," as PepsiCo only alleged "that Banner's acts harmed a third party [the debtor] and that that harm in turn led to PepsiCo's harm." *Id*. at 704. PepsiCo's claims, therefore, were dismissed for lack of standing. *Id*. at 705.

Thus, as Judge McMahon properly recognized, "*St. Paul Fire* does not stand for the proposition that the Trustee can pursue claims that belong individually to the creditors — just the opposite." SPA-14. *St. Paul* confirms that

"if a cause of action is *property of the debtor*," then a bankruptcy trustee can assert the cause of action "on behalf of the estate." 884 F.2d at 700 (emphasis added).

The Trustee seizes on dictum in *St. Paul* stating that a trustee is the proper person to bring a cause of action if the "claim is a general one, with no particularized injury arising from it, and if that claim could be brought by any creditor of the debtor." Trustee Br. 40 (quoting 884 F.2d at 701). But the *St. Paul* panel went on to explain precisely what it meant by a "general" claim: the veil-piercing claim was "general" only insofar as it belonged to *the debtor*, and thus would benefit all creditors indirectly since recoveries on the claim would go to the estate. 884 F.2d at 704. For creditors to bring the claim themselves, they would have to do so on a "derivative" basis. *See id.* at 697 (bankruptcy trustee succeeds only to rights that "can be enforced by either the corporation directly or the shareholders derivatively" (quoting *Koch Refining* v. *Farmers Union Cent. Exch., Inc.*, 831 F.2d 1339, 1343 (7th Cir. 1987))).

The limited import of *St. Paul*'s language regarding "general" claims was definitively confirmed in *Pereira* v. *Farace*, 413 F.3d 330 (2d Cir. 2005). In *Farace*, the district court held, relying erroneously on *St. Paul*, that a trustee could bring creditor claims for breach of a duty of care, reasoning that "where the injury is to all creditors as a class, it is the creditors who lack standing and the Trustee who may bring a claim based on that generalized injury." *Id*. at 342. But this

Court reversed, finding that the trustee was barred from bringing such creditor claims. The Court explained that, while the district court's statement about generalized injuries "may be true — because claims that injure all creditors as a class normally belong to the corporation — it does *not imply that the Trustee's rights are greater than the rights the corporation would have* against malfeasant directors." *Id*. (emphasis added). *Farace* thus squarely rejects the Trustee's misreading of *St. Paul*, and reaffirms the bedrock principle that trustees may only bring claims belonging to the debtor.[*]

The Seventh Circuit has similarly rejected the Trustee's misreading of *St. Paul*. In *Steinberg* v. *Buczynski*, 40 F.3d 890, 892 (7th Cir. 1994) (Posner, J.), the Seventh Circuit ruled that a bankruptcy trustee lacked standing to bring a veil-piercing claim that, in that instance, belonged to *creditors* under applicable state law. Citing *St. Paul*, the Court explained that "if a claim against the shareholders

[*] A recent case arising out of the Madoff fraud illustrates the circumstances in which *St. Paul* may vest standing in a trustee. In *Fox* v. *Picard (In re Madoff)*, 2012 WL 990829 (S.D.N.Y. Mar. 26, 2012), the district court cited *St. Paul* in barring certain Madoff customers from pursuing claims "that were the property of the BLMIS estate," that arose from "actions that harmed BLMIS and all BLMIS customers in the same way," and that were "duplicative and derivative of the Trustee's fraudulent transfer claim" against the same defendants, *id*. at *6, *8. Here, in contrast, the claims at issue are not property of the BMIS estate, do not seek to redress harms to BMIS, and are not derivative of fraudulent transfer claims.

arising from their disregard of corporate formalities is the property of *the corporation*, then the trustee can sue; otherwise he cannot." *Id*. (emphasis added).

The Seventh Circuit went on to dismiss as "perfectly circular" the reasoning espoused by the Trustee on this appeal, which posits that when recovery on a claim by the Trustee will benefit "all creditors," Trustee Br. 41, the Trustee has standing to bring the claims:

> The trustee argues that since he is, in fact, the plaintiff in this adversary proceeding . . . , any judgment he obtains will enure to the benefit of the bankrupt estate; he is therefore suing on behalf of the estate, as he is authorized to do. This reasoning is perfectly circular. Suppose a neighbor of the Buczynskis [the defendants] had slipped on ice in front of their house. Could the trustee sue the Buczynskis, on the theory that if the suit succeeded the proceeds of the suit would go to the bankrupt estate . . . ? To ask the question is to answer it.

40 F.3d at 892.

Accordingly, under controlling precedent and compelling logic, the Trustee's argument based on *St. Paul* should be rejected. The claims at issue here, far from being "generalized" claims belonging to the debtor, are classic individual claims belonging to thousands of customers, each of whom made an individual investment at a particular time, in particular amounts, and in reliance on particular representations, and thus suffered particularized injuries. There is nothing "general" about these customer claims. Indeed, in the district court, the Trustee

did not dispute "to whom the common law claims belong — the Trustee acknowledge[d] [that] they are the customers', and not the debtor's." SPA-14.

C. Under the *Wagoner* rule, the Trustee also has no authority to assert damages claims that belong to BMIS.

Despite acknowledging in the district court that his common law claims belonged to customers, the Trustee has now advanced an equivocal position on the question of whose claims he is bringing. *E.g.*, Trustee Br. 44, 46 (arguing that the common law claims belong to a "customer property estate" and do not "belong to a specific BLMIS customer").

But there is "no doubt" that the common law claims asserted by the Trustee belong to Madoff's customers. SPA-7. It was BMIS's individual *customers* who suffered the damages that the Trustee is trying to recover. Likewise, it was the *customers* who were defrauded, the *customers* who were owed fiduciary duties by BMIS, and the *customers* whose property was converted. The notion that the Trustee is really asserting common law claims belonging to Madoff's defunct brokerage firm — *i.e.*, the criminal enterprise through which Madoff perpetrated his Ponzi scheme — is facially absurd.

In any event, even if one were to indulge the fiction that the Trustee is asserting claims of the BMIS estate, he lacks standing to do so. In addition to holding that a trustee may not usurp claims belonging to creditors, *Wagoner* holds

that a claim against a third party for harming a corporation with the cooperation of management "accrues to creditors, not to the guilty corporation." 944 F.2d at 120. Under this doctrine — known as the "*Wagoner* rule" — "when a bankrupt corporation has joined with a third party in defrauding its creditors, the trustee cannot recover against the third party for the damage to the creditors." *Id.* at 118; *accord Kirschner* v. *Grant Thornton LLP*, 2009 WL 1286326, at *10 (S.D.N.Y. Apr. 14, 2009) (Lynch, J.), *aff'd*, 626 F.3d 673 (2d Cir. 2010) (applying *Wagoner* rule to dismiss fraud and breach of fiduciary claims where the debtor "participated in, and benefitted from, the very wrong for which it seeks to recover"); *Breeden* v. *Kirkpatrick & Lockhart LLP (In re Bennett Funding Grp., Inc.)*, 336 F.3d 94, 99-100 (2d Cir. 2003) (applying *Wagoner* rule to prevent trustee for Ponzi scheme operator from bringing malpractice claims); *Hirsch*, 72 F.3d at 1094-95 (same).

The *Wagoner* rule is related to the state-law doctrine of *in pari delicto*. The rule "derives from the fundamental principle of agency that the misconduct of managers within the scope of their employment will normally be imputed to the corporation." *Wight* v. *BankAmerica Corp.*, 219 F.3d 79, 86-87 (2d Cir. 2000). "[B]ecause a trustee stands in the shoes of the corporation, the *Wagoner* rule bars a trustee from suing to recover for a wrong that he himself essentially took part in." *Id.* at 87; *see also Kirschner* v. *KPMG LLP*, 15 N.Y.3d

446, 464 (2010) ("The doctrine of *in pari delicto* mandates that the courts will not intercede to resolve a dispute between two wrongdoers.").

In this case, the *Wagoner* rule and the doctrine of *in pari delicto* plainly prevent the Trustee from bringing claims as successor to BMIS. SPA-7-8. Indeed, there could hardly be a clearer case for application of the *Wagoner* rule: as alleged in the Amended Complaint, BMIS was operated for decades by Madoff, the principal officer and sole owner of BMIS, as a criminal "Ponzi scheme." A-674, A-677, A-678(¶¶ 36, 44, 46).

The Trustee and SIPC try to avoid the *Wagoner* rule by arguing that it should not apply in SIPA cases as opposed to ordinary bankruptcy cases. There is no basis for this distinction. SIPA grants a trustee the "same powers and title with respect to the debtor and the property of the debtor . . . as a trustee in a case under Title 11." 15 U.S.C. § 78fff-1(a) (SPA-51). Thus, a SIPA trustee acts as successor to the debtor in the same way as any other bankruptcy trustee. The Trustee cites no cases that exempt a SIPA trustee from the *Wagoner* rule. And lower courts in this Circuit have applied *Wagoner* to bar claims by a SIPA trustee. *See, e.g.*, *SIPC* v. *BDO Seidman, LLP*, 49 F. Supp. 2d 644, 650-51 (S.D.N.Y. 1999); *Giddens* v. *D.H. Blair & Co. (In re A.R. Baron & Co., Inc.)*, 280 B.R. 794, 799-801 (Bankr. S.D.N.Y. 2002).

Both the Trustee and SIPC also argue, in vague terms, that *in pari delicto* principles should not interfere with enforcement of the federal securities laws. Trustee Br. 48; SIPC Br. 42. But the claims at issue here, as framed by the Trustee himself, are not based on federal securities law. The Amended Complaint invokes only state law as the basis for those claims, and they are precisely the kind of claims rejected in *Wagoner* and *Hirsch*. Although the Trustee and SIPC cite *Bateman Eichler, Hill Richards Inc.* v. *Berner*, 472 U.S. 299 (1985), that case addressed the applicability of *in pari delicto* to a federal securities claim under section 10(b) of the Securities Exchange Act. The Court concluded that, in the circumstances presented, the policies underlying federal securities law would not be served by applying *in pari delicto* to prevent "a defrauded tippee [from] bring[ing] suit against his defrauding tipper." 472 U.S. at 315-16. *Bateman Eichler* has no bearing on the application of the *Wagoner* rule or *in pari delicto* to the common law claims asserted here.

The Trustee and SIPC make other policy arguments against applying the *Wagoner* rule, but they are just attacks on the rule itself. The Trustee asserts that "inequitable results" would follow from applying the *Wagoner* rule to the Trustee, who is "not a wrongdoer himself." Trustee Br. 49. SIPC, meanwhile, suggests that enforcement of the *Wagoner* rule could permit customers that bring lawsuits to recover before other customers. SIPC Br. 42-43.

If accepted, these arguments would gut the *Wagoner* rule. In every bankruptcy case, including *Wagoner* itself, the trustee is "not a wrongdoer" and seeks to recover value for "innocent" creditors. Likewise, in every bankruptcy case, enforcing *Wagoner* could result in some creditors choosing to pursue claims while others do not. But that is entirely consistent with the Supreme Court's decision in *Caplin*, where the Court recognized that creditors would make their own choices about pursuing claims, and stated that any "policy decision" to mandate a different result "must be left to Congress." 406 U.S. at 434.

The Trustee cites out-of-circuit decisions that have declined to apply *in pari delicto* principles to receivers or trustees. Trustee Br. 49-50. But these decisions have no relevance in light of *Wagoner* and New York law. In *Kirschner* v. *KPMG LLC*, the New York Court of Appeals recently considered whether there should be an exception to *in pari delicto* where a trustee or other representative, "stand[ing] in the shoes of corporate malefactors," seeks to recover damages that will benefit "blameless" creditors and shareholders. 15 N.Y.3d at 475. Rejecting the same arguments that the Trustee has made here, the Court of Appeals found no basis for such an exception in law or equity. *Id.*[*]

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[*] Although beside the point in light of *Wagoner* and *Kirschner*, the Seventh Circuit has now squarely rejected the Trustee's claim that, under *Scholes* v. *Lehmann*, 56 F.3d 750 (7th Cir. 1995), the *in pari delicto* doctrine does not apply to a trustee. Trustee Br. 49. In *Peterson* v. *McGladrey & Pullen, LLP*, 2012 WL
(*footnote continued*)

The Trustee also contends, for the first time on appeal, that the *Wagoner* rule should not have been applied because the complaint (i) alleges that Madoff acted "outside the scope of his agency" and (ii) raises other "factual questions" that preclude dismissal. Trustee Br. 45 n.15, 51-53. The first of these new contentions — *i.e.*, the invocation of the "adverse interest" exception to the *Wagoner* rule — is plainly wrong. There can be no adverse interest "where the principal and agent are one and the same," including in situations where a corporation's fraudulent agent is its "sole shareholder." *Mediators*, 105 F.3d at 827. The adverse interest doctrine is likewise inapplicable when "the corporate wrongdoer's fraudulent conduct enables the business to survive — to attract investors and customers and raise funds for corporate purposes." *Kirschner*, 15 N.Y.3d at 468.

The Amended Complaint on its face defeats any "adverse interest" argument. It alleges that BMIS was "wholly owned by Madoff," which itself precludes any "adverse interest." A-674(¶ 36). It also alleges that Madoff propped

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1088274 (7th Cir. Apr. 3, 2012), the court concluded that the language in *Scholes* that the Trustee has quoted in his brief "should not be generalized beyond the law of fraudulent conveyances and preferential transfers," *id.* at *4. The court "agree[d] with the conclusion of every other court of appeals that has addressed this subject and h[e]ld that a person sued by a trustee in bankruptcy may assert the defense of *in pari delicto*, if the jurisdiction whose law creates the claim permits such a defense outside of bankruptcy." *Id.*

up BMIS with his fraud, and that BMIS would have collapsed had the fraud ceased. A-677-78(¶¶ 44-47). The Trustee, moreover, has procured Bankruptcy Court relief by representing to the court that BMIS and Madoff were "alter ego[s]," which again is flatly at odds with an adverse interest theory. A-964.

The Trustee's broader contention that the *Wagoner* rule — a rule of *standing* — should not have been applied on a motion to dismiss is contradicted by numerous decisions. *E.g.*, *Kirschner*, 626 F.3d at 674 (affirming dismissal on the pleadings based on the *Wagoner* rule); *Mediators*, 105 F.3d at 825-27 (same); *Hirsch*, 72 F.3d at 1094-95 (same). Although the Trustee claims that "factual questions" preclude dismissal here based on the *Wagoner* rule, he does not explain what those questions are. The Trustee hints that there is some "factual question" as to whether Madoff shares responsibility with JPMorgan for customer losses — but how Madoff could lack responsibility for his fraud is too absurd for the Trustee even to articulate. Trustee Br. 52-53. The crux of the Trustee's claims is that BMIS allegedly "joined with [JPMorgan]" in the misconduct alleged in the complaint, which is the operative test under *Wagoner*. 944 F.2d at 118.

II. THE DISTRICT COURT CORRECTLY REJECTED THE TRUSTEE'S BAILEE STANDING THEORY.

The Trustee and SIPC each attempt to escape the result dictated by *Caplin* and *Wagoner* by invoking the law of bailment. The Trustee claims that, as

a SIPA trustee, he has bailment rights under SIPA that the debtor never had. SIPC, in contrast, claims that the Trustee is asserting bailment rights that originated with BMIS. Neither theory has any merit. Nor is there refuge to be taken in this Court's reversed decision in *Redington*, which permitted a SIPA trustee to assert customer claims under section 17(a) of the Securities Exchange Act as a bailee. Even if that decision were good law, which it is not, the case has no relevance here, where — unlike in *Redington* — the Trustee is the successor to a thief and is asserting common law claims.

A. SIPA does not authorize the Trustee to sue third parties as a bailee.

The Trustee argues that, under SIPA, he has a "special relationship" with a "fund of customer property" that permits him to bring claims as the bailee on behalf of a "customer property estate." Trustee Br. 26-28, 46-48. Judge McMahon rightly characterized this claim as "fanciful." SPA-31.

Not a word in the statute supports the Trustee's position. Although Congress easily could have authorized a SIPA trustee to bring common law claims on behalf of customers, it did not do so. In the section of SIPA entitled "Powers and duties of a trustee," the statute provides that a trustee "shall be vested with the *same* powers and title with respect to the debtor and the property of the debtor . . . as a trustee in a case under Title 11." 15 U.S.C. § 78fff-1(a) (SPA-51) (emphasis

added). In the same section, the statute authorizes the trustee to perform three additional tasks: to hire and fix the compensation of the broker's personnel, to utilize SIPC employees in the liquidation, and to maintain customer accounts. *Id.*

There is nothing in this section or elsewhere in SIPA that states or suggests that Congress intended to create any bailment between the Trustee and brokerage customers. The statute never uses the words "bailee," "bailor" or "bailment." Moreover, the one section of SIPA that the Trustee cites as supposed support for his bailment theory simply authorizes a trustee, when there is a shortfall in customer property, to bring claims under the Bankruptcy Code to recover "property transferred by the debtor." 15 U.S.C. § 78fff-2(c)(3) (SPA-55) (Trustee Br. 26). By authorizing a SIPA trustee to bring statutory avoidance claims, but *not* common law claims belonging to customers, that provision makes it perfectly clear that a SIPA trustee lacks power to assert customer damages claims. *See National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453, 458 (1974) ("[W]hen legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies."); *accord, e.g.*, *Safir* v. *U.S. Lines, Inc.*, 792 F.2d 19, 22 (2d Cir. 1986).

The Trustee's suggestion that he is the bailee for some kind of "customer property estate" — rather than for the customers that Madoff defrauded

— does not improve his position. SIPA makes no reference to a "customer property estate," does not purport to create any new legal entity, and certainly does not permit a trustee to bring claims on behalf of that made-up entity. The statute instead defines "customer property" as certain "cash and securities" held by the liquidating broker, 15 U.S.C. § 78lll(4) (SPA-59-60), and provides that customers have priority to that pool of assets, *id.* § 78fff-2(c)(1) (SPA-54-55). "Customer property," therefore, is simply a category of property as to which customers have priority over general creditors — it is not a new juridical person with independent rights to bring causes of action that belong to customers.

The Trustee cites no case law to support his theory that SIPA creates a new legal entity with authority to pursue customer claims. The cases cited by the Trustee merely acknowledge that claims of customers to "customer property" have priority over claims of general creditors. *In re BLMIS*, 654 F.3d 229, 233 (2d Cir. 2011) ("In a SIPA liquidation, a fund of 'customer property' . . . is established for priority distribution exclusively among customers."); *Rosenman Family, LLC* v. *Picard*, 395 F. App'x 766, 768 (2d Cir. 2010) (describing the term "customer property estate" to have the same meaning as "customer property" and explaining that "SIPA accords . . . 'customers' of the debtor priority over the distribution of 'customer property'" (quotation marks omitted)).

In addition to having no basis in the statute, the notion that the Trustee could assert claims based on a SIPA-created bailment is irreconcilable with black-letter bailment law. As Judge McMahon observed, any bailment in favor of *the Trustee* — as a person separate from BMIS — could have arisen only *after* Madoff stole his customers' property. SPA-30. A bailee, however, may only "bring an action to recover for the loss of or injury to the bailed property *while in his or her possession*." 9 N.Y. Jur. 2d Bailments and Chattel Leases § 115 (2011) (emphasis added); *see also United States* v. *Perea*, 986 F.2d 633, 641 (2d Cir. 1993) (bailee can sue for "destruction of or damage to the bailed property, by another *while in his possession*" (emphasis added)). Here, since the Trustee "was not in possession of customer funds when the alleged torts took place," there was "no damage to the property that the Trustee as bailee of those funds could pursue." SPA-30.

The Trustee, in sum, has failed to demonstrate that SIPA permits him to bring claims as a "bailee." As a result, the Trustee obtains no aid from Federal Rule of Civil Procedure 17(a), a merely procedural rule that permits a "bailee" to sue for the benefit of a bailor without joining the bailor. *See Del Re* v. *Prudential Lines, Inc.*, 669 F.2d 93, 96 (2d Cir. 1982) ("real party in interest" provisions of Rule 17(a) do not create substantive rights).

B. The Trustee has no bailment rights as successor to BMIS.

In contrast to the Trustee, SIPC argues that the Trustee is asserting the bailment rights of *BMIS*, which supposedly derive from BMIS's relationship with its customers. SIPC Br. 9 ("a SIPA trustee assumes the broker-dealer's position as bailee"). This argument also fails. Under *Wagoner* and New York law, the Trustee, as successor to a thief, has no valid bailment rights. SPA-30.

First, under the *Wagoner* rule, the Trustee lacks standing — as successor to BMIS — to sue other alleged participants in BMIS's fraud. Rather, any claims arising from BMIS's fraud on investors "are the property of those investors, and may be asserted *only by them* and to the exclusion of [the trustee]." *Hirsch*, 72 F.3d at 1094 (emphasis added). The *Wagoner* rule thus squarely prevents the Trustee from asserting BMIS's rights, if any, to sue as a "bailee." *See* Point I.C, *supra*.

New York law independently compels the same result: "no bailment can exist where the would-be bailee is a thief." *HSBC*, 454 B.R. at 33; *accord* SPA-30 ("[A] thief can never take the status of a bailee."). A bailment relationship arises if the bailee takes "lawful possession" of property "without present intent to appropriate" it. *Pivar* v. *Graduate Sch. of Figurative Art of the N.Y. Acad. of Art*, 290 A.D.2d 212, 213 (1st Dep't 2002) (quotation marks omitted); *accord Seaboard Sand & Gravel Corp.* v. *Moran Towing Corp.*, 154 F.2d 399, 402 (2d Cir. 1946);

Martin v. *Briggs*, 235 A.D.2d 192, 197 (1st Dep't 1997). In this case, BMIS took possession of customers' property precisely in order to appropriate it, and thus was never a bailee. *E.g.*, A-675-77(¶¶ 37-39, 41, 44). Thus, as successor to a thief, the Trustee has no bailment rights.

In the face of the New York rule that a thief is not a bailee, SIPC strains to argue that the Trustee's standing to sue is predicated not on New York law, but on a bailment that arose under SEC Rule 15c3-3. Judge Rakoff was understandably "mystified" by this argument. *HSBC*, 454 B.R. at 32. Rule 15c3-3, which requires a broker-dealer to maintain a minimum cash balance in a reserve account, "says *nothing* about a SIPA trustee's standing to bring common law claims against third parties." *Id.* (emphasis in original). The Rule does not mention the terms "bailee," "bailor" or "bailment," nor do any of the SEC releases that accompanied the Rule's adoption.*

Rule 15c3-3's reserve requirement differs from a bailment. A bailment of money arises if "a special or specific bank account is created, title to the funds remains with the account holder, and the funds are separated from other

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* *See* 17 C.F.R. § 240.15c3-3 (SPA-62-71); Exchange Act Release No. 9856, 37 Fed. Reg. 25224 (Nov. 29, 1972); Exchange Act Release No. 9775, 37 Fed. Reg. 20260 (Sept. 28, 1972); Exchange Act Release No. 9622, 37 Fed. Reg. 11687 (June 10, 1972); Exchange Act Release No. 9388, 36 Fed. Reg. 22312 (Nov. 24, 1971).

deposits." *Rozsa* v. *May Davis Grp.*, 152 F. Supp. 2d 526, 532 (S.D.N.Y. 2001); *accord* 8 C.J.S. Bailments § 7. Rule 15c3-3, however, "specifically contemplates the commingling of customer monies and the lending of customer securities." *Levitin* v. *PaineWebber, Inc.*, 159 F.3d 698, 706 (2d Cir. 1998). The broker is not even required to use the customers' cash to meet the Rule's segregation requirements — rather, the broker's own money can be placed in the reserve account. *See* 17 C.F.R. § 240.15c3-3(e) (SPA-70).

Notably, SIPC itself has acknowledged that ordinary customer property, as opposed to the "highly limited" category of "customer name securities," SIPC Br. 29, is *not* held by a broker as a "bailee." In a statement to Congress regarding the 1978 amendments to SIPA, SIPC stated:

> "Customer name securities" takes the place of "specifically identifiable property" as the category of securities which will be returned to individual customers outside the normal procedure for allocating and distributing customer property. Securities registered in the names of customers or in the process of being so registered on the filing date will be treated, in short, *as though they are not part of the debtor's estate, but merely held by the debtor as bailee.*

Securities Investor Protection Act Amendments: Hearings on H.R. 8331 Before the Subcomm. on Securities, Comm. on Banking, Housing and Urban Affairs, 95th Cong. 41-42 (1978) (Statement by Hugh F. Owens, Chairman of SIPC) (emphasis added). The Chairman of SIPC thus recognized that, while "customer name securities" are "held by the debtor as bailee," other property held by an insolvent

broker-dealer, including cash, becomes "part of the debtor's estate." The Trustee's damages claims have nothing to do with this "limited" category of customer name securities.*

SIPC's further assertion that "federal common law" should govern the bailment that supposedly arises under Rule 15c3-3 is equally farfetched. Federal common law exists only in "narrow areas," such as admiralty. *Texas Industries, Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630, 641 (1981). And indeed, each of the cases that SIPC cites in support of a "federal common law of bailment" is an admiralty case. SIPC Br. 36. Moreover, there is no conflict between state law and federal policy, as a bailee must take "lawful possession without present intent to appropriate" not only under New York law, but also under federal admiralty law. *Seaboard*, 154 F.2d at 402. More broadly, there is nothing in Rule 15c3-3 that conflicts with New York bailment law, and there is nothing in New York bailment

* Ignoring its own statements to Congress, SIPC relies on cases from more than a century ago to argue that ratable distribution of customers' property is consistent with bailment. SIPC Br. 38-39. The only case that arguably supports this proposition, *Rahilly* v. *Wilson*, 20 F. Cas. 176, 176-77 (D. Minn. 1872), held that a bailment was created where multiple wheat producers stored grain in a warehouse. That holding, however, was reversed. The Circuit Court found that no bailment had been created because the warehouse was not obliged to return to each producer the *same* grain that it deposited. *Rahilly* v. *Wilson*, 20 F. Cas. 179 (Circ. Ct. D. Minn. 1873).

law that conflicts with federal law protecting customers, who are entitled under *Caplin* and *Wagoner* to pursue their own claims.

C. ***Redington* is not controlling.**

In support of their argument that the Trustee can bring claims as a bailee, the Trustee and SIPC rely almost exclusively on *Redington* v. *Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978), *rev'd*, 442 U.S. 560 (1979), *on remand*, 612 F.2d 68 (2d Cir. 1979). *Redington* is not good law and, in any event, is entirely inapplicable here for numerous reasons.

1. ***Redington* is not good law.**

In *Redington*, a SIPA trustee and SIPC brought suit against an insolvent broker's accountant, asserting claims on behalf of the broker's customers for violations of the broker record-keeping provisions of section 17(a) of the Securities Exchange Act and under state common law. The district court held that section 17(a) did not create an implied private right of action, and thus did not consider whether the trustee could assert customer claims. *Redington* v. *Touche Ross & Co.*, 428 F. Supp. 483, 491 (S.D.N.Y. 1977). After dismissing the section 17(a) claim, the district court concluded that it lacked jurisdiction over the common law claims. *Id.* at 492-93.

On appeal, a divided panel of the Second Circuit reversed the district court's decision and held that customers of a failed brokerage firm had an implied

private right of action under section 17(a). *Redington* v. *Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978). The majority went on to conclude that the trustee had authority to bring the section 17(a) claim "on behalf of such customers" as a "bailee" and that SIPC had authority to bring the claim as a "subrogee" of the customer claims it had paid. *Id.* at 624-25.

The Supreme Court granted *certiorari* to address not only the issue of whether there was an implied private right of action under section 17(a) but also whether the trustee could assert that right of action. SPA-1383-84. Reversing, the Supreme Court held that there was no private right of action to enforce section 17(a), and thus that it was "unnecessary to reach" the issue of standing. 442 U.S. at 579, 567 n.9.

As a result of the Supreme Court's reversal on the threshold question of whether a cause of action existed, this Court's rulings on bailee and subrogee standing have no precedential effect. Upon receiving the Supreme Court's decision, this Court promptly issued an order vacating its prior judgment. *Redington* v. *Touche Ross & Co.*, No. 77-7183 (2d Cir. Aug. 8, 1979). The order provides "that the judgment of this court dated April 21, 1978," which had reversed the district court's decision, "hereby is vacated." *Id.*[*]

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[*] A copy of the August 8, 1979 order is attached hereto as Addendum A. A copy of the April 21, 1978 order is attached hereto as Addendum B.

In a subsequent opinion, this Court went on to acknowledge that the Supreme Court had "reversed our decision *to allow the Trustee to maintain* a private right of action" and remanded "for a decision on the Trustee's alternative bases for jurisdiction." *Redington* v. *Touche Ross & Co.*, 612 F.2d 68, 70 (2d Cir. 1979) (emphasis added). Finding no such alternative bases, this Court affirmed the district court's complete dismissal of the lawsuit for lack of subject matter jurisdiction. *Id.* at 70-73.

In light of this history, the Trustee's reliance on cases that gauge the precedential force of an opinion based on whether it was "vacated" or "reversed" refutes his own position. Trustee Br. 30. On remand, the Second Circuit vacated its prior judgment in *Redington*. An order "vacating the judgment of the Court of Appeals deprives that court's opinion of precedential effect[.]" *O'Connor* v. *Donaldson*, 422 U.S. 563, 577 n.12 (1975); *accord Brown* v. *Kelly*, 609 F.3d 467, 476-77 (2d Cir. 2010) (collecting cases). Accordingly, under the Trustee's own logic, any "precedential effect" of the original *Redington* decision has been "automatically erase[d]." Tr. Br. 30.

Even if one were to ignore the Second Circuit's *vacatur*, Judge McMahon was clearly correct that the Supreme Court's reversal in *Redington* on the basis that "no private right of action existed" deprived this Court's rulings on standing of precedential effect. SPA-28; *accord HSBC*, 454 B.R. at 34-35. In

National Railroad Passenger Corp. v. *National Association of Railroad Passengers*, the Supreme Court held that when a federal court has to determine *both* whether a statute creates a private right of action *and* who has standing to assert that right, "the *threshold question* clearly is whether [the statute] . . . creates a cause of action . . . ; for it is only if . . . a right of action exists that [a court] need consider whether the [party] ha[s] standing to bring the action." 414 U.S. at 456 (emphasis added). Accordingly, in *National Railroad*, after the Supreme Court concluded that there was no private right of action under the Rail Passenger Service Act, it further held that the question of "standing" to assert that non-existent cause of action became "immaterial." *Id.* at 465 n.13.

"[W]hen the Supreme Court reverses a lower court's decision on a threshold question," the Court "effectively holds the lower court erred by reaching" other issues, and any rulings on those issues are not precedential. *Newdow* v. *Rio Linda Union Sch. Dist.*, 597 F.3d 1007, 1041 (9th Cir. 2010). That is precisely what happened in *Redington*. As mandated by *National Railroad*, the Second Circuit in *Redington* first adjudicated whether section 17(a) created an implied private right of action and only then determined that the trustee and SIPC could assert that right of action. 592 F.2d at 624-25. The Supreme Court likewise followed this sequence: after reversing on the question of whether an implied right of action existed, the Court held that it was "unnecessary to reach" the questions of

standing. 442 U.S. at 567 n.9. As a result of the Supreme Court's reversal on the threshold question of whether a right of action existed, "whatever the Second Circuit said about standing was rendered superfluous" and non-binding. SPA-28. "To hold otherwise would give precedential effect to the determination of an issue that should never have been decided." *Newdow*, 597 F.3d at 1041; *see also Chem One, Ltd.* v. *M/V Rickmers Genoa*, 660 F.3d 626, 639-40 (2d Cir. 2011) (reasoning that is not "necessary" to a prior decision is not binding); SPA-29 ("It is holdings, not reasoning, that bind later courts.").

Indeed, in *Redington*, had the panel decided the threshold right-of-action issue correctly, it would have had no reason to reach, and thus would have recognized that it had no jurisdiction to consider, the issues of bailee or subrogee standing. On remand, this Court found that, without the section 17(a) claim, there were no "alternative bases for jurisdiction" over the trustee's suit. *Redington*, 612 F.2d at 70. As a result, as Judge Rakoff concluded, this Court did not have jurisdiction to decide the issues of standing in *Redington*, further depriving those rulings of precedential weight. *HSBC*, 454 B.R. at 34-35 (citing, *inter alia*, *Gutierrez* v. *Fox*, 141 F.3d 425, 426 (2d Cir. 1998)).

The Trustee argues that this Court in *Redington* supposedly determined that a trustee had "standing to assert state common law claims," and that this Court's "holdings" on that question were left undisturbed. Trustee Br. 30,

35. But the very first sentence of *Redington* refutes this argument: the sole issue presented was "whether a private cause of action exists under section 17 of the Securities Exchange Act . . . and if so, who may maintain *such an action*." 592 F.2d at 617 (emphasis added); *accord id*. at 624 (concluding that SIPC was "subrogated to the right of action *implied in section 17* in favor of brokers' customers against third parties" (emphasis added)).

The Trustee also argues that the questions presented in *Redington* were "independent and unrelated to one another" such that, under *Newdow*, a decision on one such independent ruling "leave[s] the decisions reached on other grounds intact." Trustee Br. 30 (quoting *Newdow*, 597 F.3d at 1041). Once again, the Trustee has mischaracterized what happened in *Redington*. The standing analysis in *Redington* was in no sense "independent" or "unrelated" to the threshold issue of whether an implied right of action existed. To the contrary, consistent with *National Railroad*, the panel only reached the standing question because it had first decided that section 17(a) contained an implied right of action. Moreover, the Court's analysis of standing was grounded in the section 17(a) claim that was before it: after concluding that the trustee could not sue on behalf of the broker, because "brokers . . . were not included in the class of those [p]rotected by section 17," the Court found that the same "considerations" did *not* "apply to an action brought by the Trustee as bailee." 592 F.2d at 624-25. As a result, although

"[m]erits questions may be independent of each other" in some cases, this Court's decision in *Redington* on the threshold right-of-action question was in no way "independent" of the secondary question of who could assert that particular right of action. *Newdow*, 597 F.3d at 1041. Rather, as in *National Railroad*, the two issues were inextricably linked.

SIPC, meanwhile, argues that "this Court's standing decision in *Redington* was a jurisdictional determination," which had to be made before reaching any other issues. SIPC Br. 52. This too is clearly incorrect. In concluding that the trustee in *Redington* was entitled to assert the section 17(a) claim as a bailee, the Court relied on Federal Rule of Civil Procedure 17(a), 592 F.2d at 625. A decision applying Federal Rule 17(a) is *not* "jurisdictional," as evidenced by the fact that the Supreme Court in *Redington* chose not to address the standing issue on appeal. 442 U.S. at 567 n.9; *see also, e.g.*, *Fox* v. *McGrath*, 152 F.2d 616, 618 (2d Cir. 1945) (citing cases holding that "real party in interest" defenses are waivable); *Rawoof* v. *Texor Petrol. Co., Inc.*, 521 F.3d 750, 756 (7th Cir. 2008) ("The requirements of Rule 17 should not be confused with the jurisdictional doctrine of standing.").

For similar reasons, the Trustee's and SIPC's reliance on *Steel Co.* v. *Citizens for a Better Environment*, 523 U.S. 83 (1998), is misplaced. That decision requires that issues of "Article III jurisdiction" be decided before other issues,

including the existence of a cause of action. *Id*. at 89. However, nothing in *Steel Co.* requires a court — in contravention of *National Railroad* — to decide non-jurisdictional questions, such as whether a plaintiff is a "real party in interest" under Fed. R. Civ. P. 17, prior to resolving such "threshold" issues as whether a cause of action exists. To the contrary, the Supreme Court in *Steel Co.* endorsed the decisional sequence prescribed by *National Railroad*, agreeing that — in the absence of a dispute as to whether there is an Article III "case or controversy" — a federal court should first consider the "threshold" issue of whether a cause of action exists before determining whether the plaintiff has "statutory standing." *Id*. at 97 & n.2.*

Finally, the Trustee blatantly mischaracterizes the case law when he says that *Redington* "has been recognized as binding precedent." Trustee Br. 21, 38. In *SIPC* v. *BDO Seidman*, 222 F.3d 63, 69 (2d Cir. 2000), this Court did not recognize *Redington* as binding. To the contrary, the Court declined the opportunity to reaffirm *Redington* and instead merely "assum[ed] *without*

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* Other cases cited by the Trustee are likewise beside the point. In *Morrison* v. *National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010), the issue presented was not the threshold issue of whether there was any implied private right of action under Section 10(b), but rather whether the plaintiffs could state a claim based on extraterritorial transactions. In *Motorola Credit Corp.* v. *Uzan*, 388 F.3d 39 (2d Cir. 2004), a RICO claim was dismissed for failure to state a claim, not based on any threshold determination.

deciding" that there was statutory standing even as it held that SIPC's asserted claims failed. 222 F.3d at 69, 71 (emphasis added). Likewise, in *Holmes* v. *SIPC*, the Supreme Court did not "acknowledge" the precedential value of *Redington*, Trustee Br. 38; rather, it expressly questioned its rationale while citing Judge Pollack's decision in *Mishkin* — which had rejected subrogee standing — with approval. 503 U.S. 258, 270 (1992).

Neither this Court nor the Supreme Court has ever held that *Redington* is good law. The district court correctly concluded that it is not.

2. *Redington* did not involve a broker that stole property from customers.

Even if *Redington* were good law, it would not support standing in this case. As Judge Rakoff noted, "there was no suggestion that the broker-dealer in *Redington* participated in a fraud whereby it intended to 'appropriate' customer property." *HSBC*, 454 B.R. at 36. Indeed, the *Redington* trustee took the position that Weis, the broker at issue, was *not* a wrongdoer, alleging instead that "Weis as an entity distinct from its conniving officers was directly damaged by Touche Ross' unsatisfactory audit." 592 F.2d at 620. In *Redington*, therefore, unlike in this case, the common law rule that a thief is not a bailee did not bar the trustee's assertion of bailment rights. Likewise, in *Redington*, the *in pari delicto* principles reflected in the *Wagoner* rule did not operate to bar the trustee's suit.

3. *Redington* did not address common law claims.

Moreover, even if *Redington* were good law, its limited holding should not be extended to give the Trustee standing to assert common law claims. "*Redington* does not anywhere hold that a SIPA trustee has standing to pursue common law claims against third parties as bailee of customer property." *HSBC*, 454 B.R. at 35; *accord Redington*, 592 F.2d at 619. Nor does it hold that SIPC can pursue common law claims against third parties as a subrogee. *Redington*, 592 F.2d at 624 (holding that SIPC is "subrogated to the right of action implied in section 17").

There is good reason to distinguish between standing to bring a section 17(a) claim and standing to bring common law claims. Common law claims, unlike federal securities claims, "generally require proof of individual reliance and causation, which may pose justiciability concerns in the context of a mass tort action by a SIPA trustee." *HSBC*, 454 B.R. at 35; *see also SIPC* v. *BDO Seidman, LLP*, 222 F.3d 63, 73 (2d Cir. 2000) (dismissing fraudulent misrepresentation claim brought by SIPC and SIPA trustee on behalf of customers on the grounds that the complaint failed to plead reliance by the customers).

In addition, interpreting *Redington* to extend to the common law claims here would put *Redington* squarely at odds with this Court's subsequent decisions in *Wagoner* and its extensive progeny, including *Mediators*, *Farace* and

Hirsch. Under those decisions, claims arising from alleged fraud on the investors in a Ponzi scheme "are the property of those investors, and may be asserted *only by them* and to the exclusion of [the trustee]." *Hirsch*, 72 F.3d at 1094 (emphasis added). If this Court's reversed decision in *Redington* has any vitality, it certainly should not be construed to conflict with this well-settled law precluding trustees from bringing precisely the sort of common law damages claims that the Trustee has asserted.

III. THE DISTRICT COURT CORRECTLY REJECTED THE TRUSTEE'S SUBROGEE STANDING THEORY.

The Trustee argues that SIPC — which has advanced approximately $800 million to satisfy or partially satisfy thousands of customer claims — is entitled to bring causes of action against third parties as a subrogee of those customer claims, and that the Trustee can enforce SIPC's supposed subrogation rights as its assignee. Trustee Br. 54-56. The district court correctly rejected this argument. SPA-31-33.

A. SIPC has no authority under SIPA to sue third parties as a subrogee.

No provision of SIPA provides SIPC with authority to bring customer claims against third parties. Instead, the statute provides that, when SIPC makes advances (of up to $500,000) to satisfy customer claims against the estate, SIPC is subrogated to those claims against the estate. Section 78fff-3(a) provides:

> To the extent moneys are advanced by SIPC to the trustee to pay or otherwise satisfy the claims of customers, in addition to all other rights it may have at law or in equity, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this chapter . . . .

15 U.S.C. § 78fff-3(a) (SPA-58). The "claims of such customers" paid by SIPC, which have the "rights and priorities provided in this chapter," are "net equity claims" — *i.e.*, claims against *the estate*. 15 U.S.C. § 78lll(11) (SPA-61). Thus, as Judge McMahon held, "SIPC's statutory subrogation right is a limited one: it permits claims only to the extent of customers' net equity claims against the [estate], and not against any other party." SPA-31; *accord HSBC*, 454 B.R. at 33.

As a result, SIPC's asserted right to sue third parties as a subrogee falls outside the limited subrogation rights granted by SIPA. Even the majority in *Redington* reached this conclusion, explaining — before granting subrogation rights to SIPC that are *not* in the statute — that "SIPA provides expressly that SIPC, upon reimbursing a customer's losses, shall be subrogated to that customer's claims against the debtor's (here Weis') estate." *Redington*, 592 F.2d at 624. Likewise, when briefing the *Holmes* case to the Supreme Court, SIPC itself "assume[d] that SIPA provides for subrogation to the customers' claims against the failed broker-dealers, but not against third parties." 503 U.S. at 270 (citations omitted).

In light of SIPA's carefully circumscribed treatment of subrogation, there is no basis to imply broader subrogation rights in favor of SIPC. As explained by Judge Mulligan's dissent in *Redington*, because SIPA delineates certain specific and limited subrogation rights, "its failure to provide for subrogation against any third party would clearly dictate that none exist under the . . . principle: *Expressio unius est exclusio alterius*." 592 F.2d at 634-35 (Mulligan, J., dissenting); *see also National Railroad*, 414 U.S. at 458 (applying the same canon; "when legislation expressly provides a particular remedy," courts should not imply other remedies). Judge Pollack likewise concluded in *Mishkin* v. *Peat, Marwick, Mitchell & Co.*, that a SIPA trustee has no legal authority to assert extra-statutory subrogation claims. 744 F. Supp. 531, 557-58 & n.15 (S.D.N.Y. 1990). This conclusion is also supported by section 78fff(a)(3) of SIPA, which states that a purpose of a SIPA liquidation is "to enforce rights of subrogation as provided *in this chapter*." 15 U.S.C. § 78fff(a)(3) (SPA-49) (emphasis added).

Congress's intent to limit SIPC's subrogation rights to claims against the debtor is further demonstrated by SIPA's priority scheme. In May 1978, after the *Redington* decision, an amendment to SIPA took effect specifying the priority of distribution of customer property. As amended, the statute provides that customer property is allocated "to SIPC as subrogee for the claims of customers" only *after* customer claims have been fully satisfied. 15 U.S.C. § 78fff-2(c)(1)

(SPA-54); *accord* 15 U.S.C. § 78fff-3(a) (SPA-58) ("SIPC as subrogee may assert no claim against customer property until after the allocation thereof to customers."). The Trustee's theory, under which SIPC is permitted to recover from third parties as a subrogee, "would effectively permit SIPC to jump the line" by recouping its advances before customers are paid in full. SPA-32.*

The Trustee's subrogation theory has profound problems even beyond its complete lack of statutory support. In *Holmes* v. *SIPC*, the Supreme Court observed that SIPC's "theory of subrogation" — essentially the same theory of extra-statutory subrogation rights advanced by the Trustee here — is "fraught with unanswered questions." 503 U.S. at 270. And so it is. One such question, unanswered by the Trustee's or SIPC's briefs, is why SIPC should be able to "assign" its subrogation rights to the Trustee when no provision of SIPA authorizes such an assignment.

The statute does not address this issue, nor does it discuss a host of other questions that would arise from the Trustee's pursuit of thousands of

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* It is no answer for SIPC to say that, as a result of its decision to assign its claims to the Trustee, the Trustee will retain any damages on those claims. SIPC Br. 47-48. SIPC's decision to forego recoveries has no bearing on whether SIPA should be read to permit SIPC to bring claims against third parties that contravene the statutory priority scheme. *FDIC* v. *Ernst & Young, LLP*, 256 F. Supp. 2d 798, 805 (N.D. Ill. 2003) (where lawsuit by FDIC would permit the FDIC to "bypass" a statutory priority scheme, the FDIC's "voluntary assurances" that it would adhere to the scheme were insufficient to support standing).

individual customer claims. For example, when SIPC pays a customer claim in full, is SIPC really entitled to bring whatever causes of action it wishes on that customer's behalf, subjecting the *customer* to unwanted discovery and trial? And when SIPC pays only part of a customer claim, can it still sue third parties as a subrogee? If so, who decides whether to sue, where to sue, what claims to pursue, and whether to settle? Likewise, if SIPC is allowed to pursue only part of a customer's claim, are determinations made in that litigation binding on the customer?

SIPA's complete silence on these important questions is strong evidence that — just as Congress never contemplated that bankruptcy trustees would prosecute creditor common law claims, *Caplin*, 406 U.S. at 434 — Congress likewise never contemplated that SIPC, upon advancing "net equity" payments to customers, would be able to spearhead a mass, common law damages action.

In the face of SIPA's narrowly defined and limited treatment of subrogation, the district court was also correct to conclude that SIPC's asserted subrogation rights were not supported by the phrase in SIPA stating that SIPC, upon paying customer claims, maintains "all other rights it may have at law or in equity." 15 U.S.C. § 78fff-3(a) (SPA-58). As the district court held, this phrase cannot "overcome the[] specific, concrete statutory impediments" to subrogee

standing. SPA-32. Other courts have likewise concluded that this "catch-all" phrase cannot be read to undermine the specific provisions of SIPA directing only that SIPC be subrogated to customer claims against the estate. *HSBC*, 454 B.R. at 34; *see also Mishkin*, 744 F. Supp. at 558.

SIPC mistakenly suggests that the "all other rights" phrase in the statute somehow codified *Redington*. SIPC Br. 48. The language had nothing to do with *Redington*. It was proposed by SIPC in November 1975 (two and a half years before this Court's first decision in *Redington*) as a "minor substantive or technical amendment[]." *Securities Investor Protection Act Amendments of 1975: Hearings on H.R. 8064 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce*, 94th Cong. 197, 199 (1976). Moreover, Congress received a report from a SIPC task force observing that "claims of SIPC as subrogee (except as otherwise provided), should be allowable *only as claims against the general estate*." *Id.* at 64 (emphasis added).*

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* The Sixth Circuit's reliance in *Appleton* v. *First National Bank*, 62 F.3d 791 (6th Cir. 1995), on the 1978 amendment to SIPA is misplaced. Although the *Appleton* court stated that a SIPA trustee's powers are "supplemented by § 78fff-3(a)," *id.* at 800, this amendment cannot fairly be read to effect a major substantive change to the statute, as shown above, especially in light of the contemporaneous amendment to the statute's priority language and the absence of any reference in the statute to subrogation rights against third parties.

B. The Amended Complaint does not adequately plead subrogation claims.

The Trustee's subrogation theory also fails on the independent basis that the Trustee has not pleaded individual claims on behalf of any supposed subrogors. As JPMorgan demonstrated in the court below, a fundamental flaw in the Amended Complaint is that the Trustee, despite purporting to aggregate and assert thousands of individual fraud claims under New York law, has failed to meet the pleading requirements applicable to any of those individual claims. This pleading failure is fatal to SIPC's purported claims as a "subrogee."

Under clear Second Circuit precedent, to recover as a subrogee, a party must identify the subrogors and provide "individualized information about the claims" that the subrogee is asserting. *Blue Cross & Blue Shield of New Jersey, Inc.* v. *Philip Morris USA Inc.*, 344 F.3d 211, 217-18 (2d Cir. 2003). Moreover, as "a general matter, a subrogation claim by an insurer depends upon the claim of the insured and is subject to whatever defenses the tortfeasor has against the insured." *Id.* at 218 (quotation marks omitted).

Blue Cross is directly on point. There, a purported subrogee sought to bring fraud claims on behalf of a large group of injured consumers without providing the number or names of the subrogors or the individual circumstances concerning the claims. This Court concluded that it was "clearly contrary to the common law understanding of the nature of subrogation claims" to proceed as a

purported subrogee without identifying the "number of subrogors or their names" or any "individualized information" about the claims. *Id.* at 217-18. Such an attempt to "proceed under the guise of subrogation was improper as it was not a true subrogation claim." *Id.* at 218. The Court thus held that the defendants were entitled to judgment as a matter of New York law. *Id.*

Here, the Amended Complaint does not allege facts to support any individual customer's claims. For instance, to sustain a fraud claim, the plaintiff must allege "a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury." *Lama Holding Co.* v. *Smith Barney Inc.*, 88 N.Y.2d 413, 421 (1996). The Amended Complaint, however, does not allege these elements with respect to any particular customer. It also does not show how JPMorgan, by providing conventional banking services to BMIS, proximately caused any customer's loss. *See Bloor* v. *Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57, 62-63 (2d Cir. 1985) (complaint for aiding and abetting "must allege that the acts of the aider and abettor proximately caused the harm"). Instead, the Trustee lumps all of Madoff's customers together as if they were one plaintiff, even though the Trustee himself has alleged that some customers

participated in Madoff's fraud and caused their own losses. *See, e.g.*, A-992-95, *Picard* v. *Fairfield Sentry Ltd. et al.*, No. 09-01239 (Bankr. S.D.N.Y.).

In light of the Trustee's failure to provide any information about individual customer claims, let alone the particularized information required by Fed. R. Civ. P. 9(b) to support claims of fraud, neither SIPC nor the Trustee may "proceed under the guise of subrogation." *Blue Cross*, 344 F.3d at 218. "At the very least, a subrogation claim would require [the Trustee] to identify its subrogors and those subrogors' claims so that defendants would have the opportunity to assert defenses against those claims." *Id.* (citing *A.O. Fox Mem'l Hosp.* v. *Am. Tobacco*, 302 A.D.2d 413 (2d Dep't 2003); *Eastern States Health & Welfare Fund* v. *Philip Morris, Inc.*, 188 Misc. 2d 638, 652-53 (Sup. Ct. N.Y. Co. 2000)). The Trustee's failure to identify the individual subrogors and their "particular injuries" mandates dismissal of his subrogation claims as a matter of law. *A.O. Fox*, 302 A.D.2d at 414; *see also Eastern States*, 188 Misc. 2d at 652-53.[*]

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[*] Although *Blue Cross* was decided after trial, the New York cases it relied upon granted motions to dismiss and the Court's logic applies fully to such motions: If information regarding subrogation claims is not pleaded, the defendants cannot assert the defenses in Fed. R. Civ. P. 12. *See also, e.g.*, *Health Care Serv. Corp.* v. *Brown & Williamson Tobacco Corp.*, 208 F.3d 579, 581 (7th Cir. 2000); *U.S.* v. *Philip Morris Inc.*, 153 F. Supp. 2d 32, 39 (D.D.C. 2001).

IV. THE DISTRICT COURT CORRECTLY DISMISSED THE TRUSTEE'S CONTRIBUTION CLAIM.

The Trustee seeks contribution for the payment of "customer claims" filed in the SIPA liquidation, including claims the Trustee has not yet paid. A-800(¶¶ 588-89). The district court correctly dismissed this claim on the grounds, among others, that: (1) SIPA does not permit a trustee to seek contribution for payments to customers; and (2) even apart from SIPA, the Amended Complaint does not state a contribution claim under New York law. SPA-18-22.

A. The Trustee has no authority under SIPA to seek contribution for payments to customers.

A right to contribution exists under a federal statute if the statute provides for such a right, "either expressly or by clear implication." *Texas Indus., Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630, 638 (1981) (no right of contribution under the Sherman Act or Clayton Act); *see also Nw. Airlines, Inc.* v. *Transp. Workers Union of Am.*, 451 U.S. 77, 94-95 (1981) (no right of contribution under the Equal Pay Act or Title VII of the Civil Rights Act of 1964); *Lehman Bros., Inc.* v. *Wu*, 294 F. Supp. 2d 504, 505 (S.D.N.Y. 2003) (no right of contribution under the Copyright Act); *LNC Invs., Inc.* v. *First Fid. Bank*, 935 F. Supp. 1333, 1346 (S.D.N.Y. 1996) (no right of contribution under the Trust Indenture Act).

As the district court concluded, SIPA does not provide the Trustee with a contribution right for payments to customers mandated by the statute.

SPA-21; *HSBC*, 454 B.R. at 37-38. SIPA requires a trustee to distribute customer property to the broker's customers ratably based on their "net equities."* But nothing in SIPA empowers a trustee to seek contribution for those payments. To the contrary, although SIPA expressly provides that a trustee can bring avoidance actions, 15 U.S.C. § 78fff-2(c)(3) (SPA-55), it makes no similar provision for contribution claims. "If Congress had intended to confer upon the Trustee authority to seek contribution for payments of customer claims, it would have said so in SIPA," the comprehensive statutory scheme that governs the brokerage liquidation process. *HSBC*, 454 B.R. at 38; *see also Nw. Airlines, Inc.*, 451 U.S. at 97 (rejecting contribution right omitted from "a comprehensive legislative scheme including an integrated system of procedures for enforcement").

Lacking contribution rights under SIPA itself, the Trustee seeks to assert a claim under New York's contribution statute. However, as this Court has held, where payments are compelled by a federal statutory scheme — rather than by state law — the defendant must look to *federal law* for any contribution rights.

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* 15 U.S.C. § 78fff-2(b) (SPA-53-54) ("After receipt of a written statement of claim [by a customer]," the trustee "shall promptly discharge . . . all obligations of the debtor to a customer relating to, or net equity claims based upon, securities or cash."); 15 U.S.C. § 78fff-2(c) (SPA-54) (directing that the Trustee "shall allocate customer property of the debtor . . . to customers of such debtor, who shall share ratably in such customer property on the basis and to the extent of their respective net equities").

Herman v. *RSR Sec. Serv. Ltd.*, 172 F.3d 132, 144 (2d Cir. 1999) (affirming dismissal of New York state law contribution claims for liability under the Fair Labor Standards Act); *see also KBL Corp.* v. *Arnouts*, 646 F. Supp. 2d 335, 341 (S.D.N.Y. 2009) (plaintiff seeking contribution for expenses from Copyright Act litigation could not "use New York State common law as an end-around to make a claim for contribution that it could not make under the federal statutory scheme"); *LNC Inv., Inc.*, 935 F. Supp. at 1349 ("Because federal law provides no right of contribution under the [Trust Indenture Act], there likewise can be no right of contribution for violations of the TIA under state law."); *Lehman Bros.*, 294 F. Supp. 2d at 505 n.1 ("[W]hether contribution is available in connection with a federal statutory scheme is a question governed solely by federal law." (quotation marks omitted)).

In the district court, the Trustee "acknowledge[d] that, 'The compulsion to pay in this case is the Trustee's obligation to pay customer claims *under SIPA*.'" SPA-20 (emphasis in original). On appeal, however, the Trustee asserts that his claim for contribution "does not arise out of SIPA," but rather is "grounded in New York law" and is "based on the breach of state law duties." Trustee Br. at 62, 65. But it is beside the point that the Trustee has brought state law claims against *JPMorgan* for breach of state law duties. Those claims are *not* the basis of the Trustee's obligation to make the payments for which he seeks

contribution. The payments to customers, for which the Trustee is seeking contribution, are indisputably mandated by *SIPA*.

The Trustee's own authorities establish that the Trustee cannot look to state law for contribution rights when his obligation to pay customers arises from a federal statute. In *Northwest Airlines*, the Supreme Court explained that federal courts have recognized state-law contribution rights only "in cases in which state law supplied the appropriate rule of decision," *i.e.*, cases in which the underlying obligation is based on state law. 451 U.S. at 97 n.38. But since the case before it involved liability under a federal statutory scheme, the Court looked only to federal law for contribution rights and said that "it would be improper for us to add a right to contribution to the statutory rights that Congress created." *Id*. at 98.

Likewise, in *LNC Investments*, Judge Mukasey permitted a defendant to bring a state law contribution claim on the basis of the plaintiffs' breach of fiduciary duty claim, but held that the defendant could *not* maintain a state law contribution claim on the basis of an alleged violation of the Trust Indenture Act, a federal statute. 935 F. Supp. at 1348-49. As the court explained, "[t]he source of a right of contribution under state law must be *an obligation imposed by state law*." *Id.* at 1349 (emphasis added). Notably, Judge Mukasey rejected the contribution claim based on the Trust Indenture Act even while finding that the alleged joint tortfeasor had potential liability under a *state law* theory of breach of fiduciary

duty. 935 F. Supp. at 1348-49, 1353. Judge Mukasey thus recognized that where — as in this case — the party seeking contribution is required by a *federal statute* to make payments, but asserts claims against third parties based on *state law*, any contribution rights must still be grounded in federal law.

The other cases cited by the Trustee are inapposite, because they involve contribution claims for obligations imposed by state law or contract. For example, in *Hill* v. *Day (In re Today's Destiny, Inc.)*, 388 B.R. 737, 753-56 (Bankr. S.D. Tex. 2008), a debtor sought contribution under Texas law for obligations set forth in proofs of claim alleging fraud. The claimants there could recover only by establishing liability for the state law torts. Here, by contrast, the Trustee's obligation to make payments to customers derives from SIPA, and customers need not prove any state law tort claims.*

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* The Trustee's other cases are similarly inapposite. *See Westerhoff* v. *Slind*, 688 F.2d 62, 63 (8th Cir. 1982) (contribution for payments on promissory note); *Friedman* v. *Morabito*, 1995 WL 502909, at *1 (4th Cir. 1995) (contribution for payment on loan guaranty); *A.P.I., Inc.* v. *Home Ins. Co.*, 706 F. Supp. 2d 926, 946 (D. Minn. 2010) (contribution for payments on insurance policies); *Seitter* v. *Schoenfeld*, 88 B.R. 343, 348 (D. Kan. 1988) (contribution for liability on fraud and contract claims); *Kotoshirodo* v. *Hancock*, 2009 WL 2225450, at *5 (Bankr. D. Haw. July 23, 2009) (contribution for payment on note guaranty). In *Kittay* v. *Atl. Bank of New York*, 316 B.R. 451, 464 (Bankr. S.D.N.Y. 2004), the contribution claim was dismissed, and *SIPC* v. *Cheshier & Fuller, LLP*, 377 B.R. 513, 570 (Bankr. E.D. Tex. 2007), involved comparative negligence.

In sum, the Trustee has failed to identify any case holding that a SIPA trustee may seek contribution for payments to customers under the statute. Instead, the Trustee asks this Court to engraft an unprecedented contribution remedy onto a comprehensive statutory scheme that has never been read to grant such a remedy. As the Supreme Court directed in *Northwest Airlines*, "[t]he judiciary may *not*, in the face of such comprehensive legislative schemes, fashion new remedies that might upset carefully considered legislative programs." 451 U.S. at 97 (emphasis added).

B. The Amended Complaint fails to plead the elements of contribution under New York law.

Even if the Trustee could invoke New York law, he has failed to state a claim under New York's contribution statute. Under New York law, joint tortfeasors "who are subject to liability for damages for the same personal injury, injury to property or wrongful death, may claim contribution among them." N.Y. C.P.L.R. § 1401 (SPA-71). The amount of contribution that may be recovered "shall be the excess paid by [one tortfeasor] over and above his equitable share of the judgment recovered by the injured party." N.Y. C.P.L.R. § 1402 (SPA-71).

The Trustee's contribution claim fails on numerous grounds. *First*, it is well established that a contribution claim must be based on an adverse judgment of shared "tort liability." *Bd. of Educ.* v. *Sargent*, 71 N.Y.2d 21, 28 (1987). As the

district court recognized, the Trustee's obligation to pay BMIS customers arises from SIPA, not from "liability for damages" under state law. SPA-18. Under SIPA, customers of a broker have a statutory entitlement to receive distributions of "customer property" ratably based on their "net equities," irrespective of any tort liability. *See* 15 U.S.C. § 78fff-2(c) (SPA-54). The payments for which the Trustee seeks contribution — customer claims that he has "allowed" and advances made by SIPC — did not require or result in any predicate determination of state-law tort liability against BMIS. SPA-20.

Second, the Trustee has failed to plead that BMIS has paid, or ever will pay, more than its "equitable share" of any judgment, as required to state a contribution claim. *Andrulonis* v. *U.S.*, 26 F.3d 1224, 1233 (2d Cir. 1994) (right of contribution does not accrue "unless and until the defendant pays the plaintiff an amount exceeding its equitable share of the primary judgment"). Given that the Trustee's and SIPC's obligation to pay net equity claims is set by federal statute, there can be nothing "inequitable" about the amount of those payments.

Third, the Trustee has never impleaded JPMorgan into an underlying proceeding. New York law is clear: in the absence of a valid impleader, a joint tortfeasor cannot bring a contribution claim until it actually pays more than its equitable share. *See Andrulonis*, 26 F.3d at 1233; *Alside, Inc.* v. *Spancrete Ne., Inc.*, 84 A.D.2d 616, 617 (3d Dep't 1981). Faced with this limitation, the Trustee

purports to "implead" JPMorgan into "the SIPA Proceeding" — *i.e.*, the brokerage liquidation before Bankruptcy Judge Lifland — "pursuant to Rule 14 of the Federal Rules of Civil Procedure and Rule 7014 of the Federal Rules of Bankruptcy Procedure." A-671(¶ 21). The Trustee's theory appears to be that JPMorgan, simply by virtue of the Amended Complaint against it, should be treated as a third-party defendant as to every customer claim filed against the estate. There is no basis for this procedural hocus-pocus. Under Bankruptcy Rule 7014, Rule 14 applies only "in adversary proceedings," not in contested matters such as objections to claims. *See* F.R.B.P. 7001. The Trustee, moreover, has never filed any motion to implead JPMorgan into any claims proceeding.

C. The contribution claim is barred by the *Wagoner* rule.

Alternatively, the Trustee's contribution claim — which he says is brought as "successor-in-interest to BLMIS," A-671(¶ 21) — is barred by the *Wagoner* rule. If the Trustee were permitted to bring New York law contribution claims against JPMorgan, even though his payments to customers are compelled by SIPA rather than New York tort law, then the contribution claim fails under *Wagoner*, for "a trustee cannot sue to recover for a wrong undertaken by the debtor itself." *Kirschner*, 2009 WL 1286326, at *1.

The Trustee may argue that parties seeking contribution are necessarily *in pari delicto*. But "[t]he *Wagoner* rule is a *standing* rule — it says

that a bankrupt corporation cannot sue a third party for fraud that the corporation itself participated in." *Am. Tissue, Inc.* v. *Arthur Andersen, L.L.P.*, 2003 WL 22909155, at *4 (S.D.N.Y. Dec. 9, 2003) (emphasis in original). In this context, because BMIS is in bankruptcy, the *Wagoner* rule dictates that BMIS's customers, not the Trustee, are the proper parties to pursue claims against joint tortfeasors. *See Wagoner*, 944 F.2d at 120; *see also Devon Mobile Commc'ns Liquidating Trust* v. *Adelphia Commc'ns Corp.*, 322 B.R. 509, 529 (Bankr. S.D.N.Y. 2005) (standing requirements "cannot be circumvented by the expedient of filing a third-party complaint" and denominating the claims as "claims for contribution"). The Trustee's contribution claim, if permitted to go forward, would be nothing more than an end-run around the bedrock rule that creditors of a fraudulent debtor should control their own tort claims.

V. THE TRUSTEE'S COMMON LAW CLAIMS ARE PRECLUDED BY SLUSA.

The Securities Litigation Uniform Standards Act provides an alternative basis for dismissal. In holding that the Trustee lacked authority to assert claims on behalf of Madoff's customers, the district court did not need to reach JPMorgan's alternative argument that SLUSA preempts this state law securities fraud case aggregating thousands of customer claims. As shown below, the Trustee has resorted to state common law to avoid the pleading and substantive

requirements imposed by federal securities law. But in so doing, the Trustee has run headlong into SLUSA, which mandates that securities mass actions be litigated in federal court under federal law.

A. SLUSA broadly forecloses securities mass actions based on state law.

SLUSA had its genesis in the Private Securities Litigation Reform Act, which imposed new procedural and substantive requirements for filing securities actions. Congress enacted the PSLRA to curb "perceived abuses of the class-action vehicle in litigation involving nationally traded securities." *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 81-82 (2006). But this reform had an unintended consequence: it prompted the filing of securities suits under state law, often in state court, by plaintiffs seeking to circumvent "the obstacles set in their path by the [PSLRA]." *Id.* at 82.

Congress enacted SLUSA in 1998 to "'prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives' of the Reform Act." *Id.* (quoting SLUSA, Pub. L. No. 105-353, §§ 2(2), (5), 112 Stat. 3227 (1998) (quotation marks omitted)). SLUSA accomplished this objective "by making federal court the exclusive venue for class actions alleging fraud in the sale of certain covered securities and by mandating that such class actions be governed *exclusively by federal law*." *Lander* v.

Hartford Life & Ann. Ins., 251 F.3d 101, 108 (2d Cir. 2001) (emphasis added). The United States Supreme Court has held that SLUSA must be given a "broad construction" to effectuate Congress's intent. *Dabit*, 547 U.S. at 85-86.

SLUSA's preemption provision states as follows:

> No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging —
>
> (A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or
>
> (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

15 U.S.C. § 78bb(f)(1) (SPA-42); *see also* § 77p(b) (SPA-41). SLUSA thus mandates dismissal of (1) any covered class action, (2) based on state law, (3) alleging a material misrepresentation or omission or the use of a manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security. *E.g.*, *Romano* v. *Kazacos*, 609 F.3d 512, 518 (2d Cir. 2010).

A plaintiff cannot avoid SLUSA on the basis that not all claims in the complaint are styled as "fraud" claims. SLUSA preempts any "*action* . . . alleging a misrepresentation or omission," regardless of what labels plaintiffs may place on their claims. 15 U.S.C. §§ 78bb(f)(1) (SPA-42), 77p(b) (SPA-41) (emphasis added); *see also, e.g.*, *Leykin* v. *AT&T Corp.*, 216 F. App'x 14, 17 (2d Cir. 2007) (SLUSA preempted claim for breach of fiduciary duty); *In re Herald, Primeo, and*

Thema Sec. Litig., 2011 WL 5928952, at *4 (S.D.N.Y. Nov. 29, 2011) (SLUSA preempted claims for aiding and abetting breach of fiduciary duty, conversion, gross negligence, and unjust enrichment); *In re J.P. Jeanneret Assocs., Inc.*, 769 F. Supp. 2d 340, 378-81 (S.D.N.Y. 2011) (SLUSA preempted claims for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and unjust enrichment); *Levinson* v. *PSCC Servs.*, 2009 WL 5184363, at *12-13 (D. Conn. Dec. 23, 2009) (SLUSA preempted aiding and abetting conversion claim).

B. SLUSA preempts the Trustee's claims on behalf of Madoff's customers.

1. This action is based on state law.

The common law damages claims asserted against JPMorgan are all brought under state law.

2. This action alleges misrepresentations or omissions in connection with the purchase or sale of securities.

The Amended Complaint contains allegations of material misrepresentations and omissions in connection with the purchase or sale of a covered security. It alleges that Madoff made "intentional misrepresentation[s] of fact" to carry out his fraudulent scheme — namely, he falsely claimed to be purchasing and selling publicly traded securities — and that JPMorgan "substantially assisted" Madoff's securities fraud. A-678(¶ 47); A-675-76(¶¶ 38-

41); A-729(¶ 239). The Amended Complaint further alleges that JPMorgan "ignored blatant misrepresentations" and engaged in "fraud" because it did not report Madoff's securities fraud to regulators. A-726(¶ 231); A-799(¶ 583).

There is no question that the securities Madoff purported to be buying and selling were "covered securities" under SLUSA. A security is a "covered security" if it is listed or authorized for listing on the New York Stock Exchange or another national exchange. *See* 15 U.S.C. § 77r(b), *cited in* 15 U.S.C. §§ 78bb(f)(5)(E), 77p(f)(3). The stocks in the S&P 100 Index that Madoff reported he was trading are publicly traded, as are S&P 100 options that he reported he was trading. *See* A-675-76(¶¶ 38-39); *Herald*, 2011 WL 5928952, at *6 ("Madoff's purported trading strategy utilized 'indisputably covered securities.'" (citation omitted)).

Under SLUSA, it makes no difference that Madoff never actually traded the covered securities. In *SEC* v. *Zandford*, the Supreme Court observed that "the SEC has consistently adopted a broad reading of the phrase 'in connection with the purchase or sale of any security'" and has "maintained that a broker who accepts payment for securities that he never intends to deliver . . . violates § 10(b) and Rule 10b-5." 535 U.S. 813, 819 (2002). The *Zandford* Court found the SEC's interpretation to be "reasonable" and entitled to deference. *Id.* at 819-20.

Consistent with *Zandford*, courts in this Circuit have held that Madoff's falsified securities trades satisfy SLUSA's covered securities requirement. *See Jeanneret*, 769 F. Supp. 2d at 363 ("[A]ll of my colleagues who have encountered this issue in Madoff-related cases have concluded that, in the context of his Ponzi scheme, the 'in connection with' requirement is satisfied by his phony purchases and sales."); *accord Herald*, 2011 WL 5928952, at *8; *Barron* v. *Igolnikov*, 2010 WL 882890, at *4 (S.D.N.Y. Mar. 10, 2010); *In re Beacon Assocs. Litig.*, 745 F. Supp. 2d 386, 410-11 (S.D.N.Y. 2010).

These decisions are fully consistent with the case law outside the Madoff context. *See, e.g.*, *Instituto de Prevision Militar* v. *Merrill Lynch*, 546 F.3d 1340, 1347-51 (11th Cir. 2008) (SLUSA precluded class action seeking to hold defendant liable for fraud in which third party stole investors' money rather than purchasing securities); *Falkowski* v. *Imation Corp.*, 309 F.3d 1123, 1129-30 (9th Cir. 2002) (SLUSA precluded class action relating to unexercised stock options because "if a person contracts to sell a security, that contract is a 'sale' even if the sale is never consummated"), *amended by* 320 F.3d 905 (9th Cir. 2002); *see also In re Jett*, Securities Act Rel. No. 8395, Exchange Act Rel. No. 49366, 2004 SEC LEXIS 504, at *72 & n.41 (Mar. 5, 2004) ("When a person portrays activities as securities purchases and sales that, in fact, are no such thing, that conduct can, and here does, constitute securities fraud." (citing cases)).

3. This is a "covered class action" under SLUSA.

SLUSA defines "covered class action" to include not only actions styled as class actions, but all lawsuits in which common issues other than reliance predominate and (1) "damages are sought on behalf of more than 50 persons" or (2) the plaintiffs are suing "on a representative basis on behalf of themselves and other unnamed parties similarly situated." 15 U.S.C. §§ 77p(f)(2)(A) (SPA-41), 78bb(f)(5)(B) (SPA-42-43).

This lawsuit is a "covered class action." The Trustee's causes of action aggregate and assert thousands of separate, individual claims of Madoff's customers. Indeed, in seeking to pursue claims as a "bailee," the Trustee's original complaint expressly acknowledged that his claims were brought "on behalf of" customers, the very language of SLUSA's covered class action definition. A-35(¶ 17(f)). The Trustee's tactical deletion of that phrase in no way changes the substance of his claims, which invoke customer rights to recover customer losses.

In seeking to avoid the reach of SLUSA, the Trustee and SIPC have relied on SLUSA's "Counting" provision, which states that a "corporation . . . or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action." 15 U.S.C. §§ 77p(f)(2)(C) (SPA-42), 78bb(f)(5)(D) (SPA-43). By its terms, however, that provision is not an exception to the "covered class action" definition. Rather,

it simply clarifies that when an entity such as a corporation brings an action, it will generally count as one person under SLUSA — so that a claim brought by a corporation *on its own behalf* will not run afoul of SLUSA. The provision, in other words, respects "the usual rule of not looking through an entity to its constituents unless the entity was established for the purpose of bringing the action." *LaSala* v. *Bordier et Cie*, 519 F.3d 121, 132-33 (3d Cir. 2008).

SLUSA's counting provision, therefore, does not help the Trustee. Under the plain language of the statute, the relevant question is whether the plaintiff is bringing claims "*on behalf of*" more than 50 persons; if he is, it makes no difference if the plaintiff is "one person" or many.

The Third Circuit's decision in *LaSala* is on point. In *LaSala*, the trustees for a liquidating trust brought claims that had been assigned to the trust by a bankrupt debtor as well as claims that had been assigned to the trust by purchasers of the debtor's stock. The court concluded that the claims that originally belonged to the debtor corporation were *not* barred by SLUSA, because those claims alleged an injury to the debtor, a single entity. 519 F.3d at 133-34. By contrast, the court found that the claims that originally belonged to the

purchasers "would seem to take the form of a covered class action." *Id.* at 138.*
In drawing this distinction, the Third Circuit explained that, where claims are aggregated by a single plaintiff, SLUSA applies with full force when "the *original owners* of the claim" number more than 50. *Id.* at 134 (emphasis added).

It makes no difference that the plaintiff here is a trustee rather than a typical lead plaintiff. As the Third Circuit explained in *LaSala*, "Congress's clear intent [for SLUSA] not to reach claims asserted by a bankruptcy trustee" embraced only "claims that *the debtor-in-possession once owned*." *LaSala*, 519 F.3d at 135 (emphasis added). In a case such as this one, therefore, where the Trustee is seeking to assert claims that the debtor BMIS *never* owned, SLUSA controls.

The recent decision of the New York Court of Appeals in *RGH Liquidating Trust* v. *Deloitte & Touche LLP*, 17 N.Y.3d 397 (2011), does not support a different result. There, the Court of Appeals — over a strong dissent by Judge Robert Smith — held that a liquidating trust that succeeded to a debtor's rights under a chapter 11 plan was not precluded by SLUSA from bringing state law claims against accountants and managers that the debtor's bondholders had assigned to the debtor. Noting that the question presented was a "difficult one"

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* The Court ultimately found that SLUSA did not apply to the claims that originally belonged to the purchasers because they were based on foreign law. 519 F.3d at 138, 143.

that would "be resolved by the federal courts," *id*. at 406 & n.6, the majority concluded that, under SLUSA's "Counting" provision, the liquidating trust could pursue its claims in its capacity as a "single entity" asserting the debtor's rights. The Court analogized the liquidating trust at issue to the trust addressed by the Third Circuit in *LaSala*, which was permitted to pursue claims against third parties that originally belonged to the bankrupt debtor. *Id*. at 412-14.

Judge Smith's dissent in *RGH Liquidating Trust* persuasively refutes the majority's reasoning. As explained by Judge Smith, the lawsuit at issue was manifestly brought "on behalf of more than 50 persons," since the trust was "the assignee of more than 50 bondholders." *Id*. at 415-17. Judge Smith reasoned that SLUSA's "Counting" provision is "not relevant," because "even if the Trust is 'treated as one person' it is still suing 'on behalf of' more than 50 others — just as a class representative may be one person, but a class action will still be barred by SLUSA." *Id*. at 416 (quoting 15 U.S.C. § 78bb(f)(5)(D)).

In addition, it is clear that Judge Smith had the correct reading of *LaSala*. As Judge Smith explained, "the critical fact supporting the Third Circuit's holding that the case was not barred by SLUSA" was that "the claims being litigated there had originally belonged not to many entities, but to one, a bankrupt company." *Id*. at 417. In contrast, with respect to claims that originally belonged

to purchasers of the company's stock, the Third Circuit concluded that they *did* fit within the definition of "covered class action." *LaSala*, 519 F.3d at 137-38.

In any event, the Trustee here, in contrast to the trust in *RGH Liquidating Trust*, is not asserting claims that were assigned to the debtor (or even the Trustee). Rather, the Trustee purports to assert claims on behalf of thousands of customers that have never consented to the Trustee's pursuit of those claims. The mass action that the Trustee seeks to bring is irreconcilable with SLUSA.

CONCLUSION

For the reasons set forth herein, the judgment of the district court should be affirmed.

Dated: April 5, 2012

Respectfully submitted,

By: /s/ John F. Savarese

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CERTIFICATE OF COMPLIANCE WITH FRAP 32(A)

I hereby certify that:

1. This brief complies with the March 14, 2012 Order of the United States Court of Appeals for the Second Circuit (Carney, J.) granting Defendants-Appellees permission to file one oversized brief of up to 17,500 words, because this brief contains 17,495 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the typestyle requirements of Fed. R. App. P. 32(a)(6) because the brief has been prepared in a proportionally spaced typeface using Microsoft Office Word 2003 in 14-point Times New Roman font.

Dated: April 5, 2012

Respectfully submitted,

/s/ John F. Savarese

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Attorneys for Defendants-Appellees

Addendum A

United States Court of Appeals

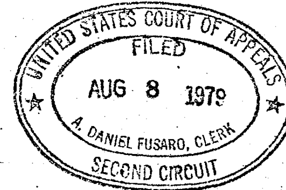
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eighth day of August, one thousand nine hundred and seventy-nine.

Present: HON. J. EDWARD LUMBARD
Circuit Judge

HON. WILLIAM H. MULLIGAN
Circuit Judge

HON. WILLIAM H. TIMBERS
Circuit Judge



77-7183
77-7186

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

v.

TOUCHE ROSS & CO.,

Defendant-Appellee.

77-7183, 77-7186

The action herein having been taken to the Supreme Court of the United States by writ of certiorari and a certified copy of the judgment and a copy of the opinion of the said court having been received and filed, reversing the judgment of this court with costs and remanding the said action to this court for further proceedings in conformity with said opinion of said court,

Upon consideration thereof, it is

Ordered that the judgment of this court of April 21, 1978 be and it hereby is vacated and that the petitioner, Touche Ross Co., recover from Edward S. Redington etc., et al Ten Thousand and Nine Hundred and Fifty-seven Dollars ($10,957.00) for their costs in the Supreme Court of the United States.

A. DANIEL FUSARO,
Clerk

BY: Edward J. Guardaro,
Deputy Clerk

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FILED IN COURT	8/8/79
D & E DKS	8/15/79

Addendum B

United States Court of Appeals

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-first day of April one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD

HON. WILLIAM H. MULLIGAN

HON. WILLIAM H. TIMBERS

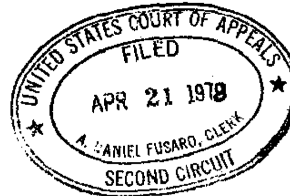
Circuit Judges,

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

v.

TOUCHE ROSS & CO.,
Defendant-Appellee

77-7183



Appeal from the United States District Court for the Southern District of New York

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and the action be and it hereby is remanded to said district court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellee.

A. DANIEL FUSARO,
Clerk

BY: Arthur Heller
ARTHUR HELLER,
Deputy Clerk

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