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

| | |
|---|---|
| In re:<br><br>BERNARD L. MADOFF INVESTMENT SECURITIES LLC,<br><br>Debtor. | SIPA LIQUIDATION<br><br>No. 08-01789 (BRL)<br><br>(Substantively Consolidated) |
| DIANE PESKIN, et al.,<br><br>Plaintiffs,<br><br>v.<br><br>IRVING H. PICARD, as Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC,<br><br>Defendant. | Adv. Pro. No. 09-01272 (BRL) |

**MEMORANDUM OF LAW IN SUPPORT OF DEFENDANT IRVING H. PICARD, TRUSTEE'S, MOTION TO DISMISS COMPLAINT, OR IN THE ALTERNATIVE, TO STRIKE**

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Defendant Irving H. Picard, trustee ("Trustee") for the substantively consolidated Securities Investor Protection Act ("SIPA"), 15 U.S.C. § 78aaa *et seq.*,[1] liquidation of Bernard L. Madoff Investment Securities LLC and Bernard L. Madoff (collectively, "Debtors"), respectfully submits this memorandum of law, as well as the declarations of David J. Sheehan and Matthew B. Greenblatt, in support of his motion, brought Pursuant to Rule 12 of the Federal Rules of Procedure, made applicable to this proceeding by Federal Bankruptcy Rule 7012,[2] to dismiss the complaint (the "Complaint") filed by plaintiffs Diane Peskin, Roger Peskin, and Maureen Ebel (collectively, "Plaintiffs") or in the alternative, to strike certain portions of the Complaint.

## PRELIMINARY STATEMENT

Plaintiffs' Complaint employs repetitive, conclusory legal allegations that fail to meet even the liberal pleading standards set forth in Fed. R. Civ. P. 8. Not only does the Complaint violate this Court's order of December 23, 2008 (the "Claims Procedure Order"), establishing the claims process for this SIPA liquidation, but it also demonstrates why the Federal Rules require a factual and legal investigation prior to bringing a complaint. Tellingly, the gravamen of Plaintiffs' action – that the Trustee's definition of "net equity" should be rejected in favor of a definition to Plaintiffs' liking – is contrary to Plaintiffs' own pecuniary interests. Put simply, Plaintiffs, having deposited far more money at BLMIS than they withdrew, will recover substantially more money if their request for declaratory relief is denied.

The fact that Plaintiffs and/or their counsel fail to understand the effect of the declaration they seek underscores all of the reasons that substituting adversary proceedings for objections to the Trustee's determination of customer is inappropriate. Plaintiffs should not be allowed to

[1] Subsequent references to SIPA shall omit "15 U.S.C."

[2] This adversary proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b).

circumvent the Claims Procedure Order merely because it suits their fancy. This alone is sufficient grounds for dismissing the Complaint.

Aside from lacking common sense, Plaintiffs' request for declaratory relief is jurisdictionally deficient. A request for declaratory relief requires a justiciable controversy that presents a real, substantial, existing controversy. Plaintiffs seek a declaratory judgment requesting that, in essence, requires the Trustee to employ a definition of net equity that would: (i) diminish the assets sought to be recovered by the Trustee; and (ii) decrease Plaintiffs' ultimate share of that recovery. Fundamentally, Plaintiffs' claim seeks a policy decree that will not positively impact Plaintiffs. Importantly, Plaintiffs cannot show that absent the Court hearing their declaratory claim, they will suffer any harm; to the contrary, Plaintiffs will be enriched if the Court declines jurisdiction. Plaintiffs are permitted to donate their excess money to charity – they are not permitted to waste time and judicial resources seeking a declaration to change a principle that does not harm their personal legal rights. Accordingly, Plaintiffs' request for declaratory judgment on the issue of "net equity" should be dismissed for lack of subject matter jurisdiction.

The remaining requests for declaratory relief are equally meritless. Despite the clear law to the contrary, Plaintiffs seek a declaration that the Trustee is not entitled to seek recovery of preferences under the Bankruptcy Code. Not only does this allegation fly in the face of the plain language of the statute, it is irrelevant to two of Plaintiffs' three accounts. The law is clear that preferences are actionable, and given this clear statutory authority, Plaintiffs' request for a declaration to the contrary should be dismissed.

Equally devoid of legal predicate is Plaintiffs' claim for breach of fiduciary duty. Once again, it is clear that the Trustee's duty is not to Plaintiffs as individual customers, or even to a

particular class of creditors. Rather, the Trustee's duty is to the estate as a whole and Plaintiffs have not alleged such a breach. Thus, the Plaintiffs cause of action must fail.

Apparently operating under the misguided belief that they were being harmed, rather than undertaking diligent factual or legal investigation, Plaintiffs alleged a variety of irrelevant and impertinent allegations. Specifically, the Complaint levels several *ad hominem* attacks against the Trustee, patches together conspiracy theories, and cites and quotes cases rather than setting forth clear and concise factual allegations. Accordingly, to the extent that the Complaint is not dismissed, certain portions of the Complaint should be stricken.

Plaintiffs have no substantive or procedural reasons to bring this action against the Trustee and they should not be permitted to waste the resources of the Trustee, the estate, and the Court. Accordingly, for the reasons detailed herein, Plaintiffs' Complaint is frivolous and should be dismissed or, at the very least portions thereof should be stricken.

## STATEMENT OF FACTS

### A. Procedural History

On December 11, 2008, Madoff was arrested by the FBI in his Manhattan home and was criminally charged with a multi-million dollar securities fraud scheme in violation of 15 U.S.C. §§ 78j(b), 78ff, and 17 C.F.R. 240.10b-5 in the United States District Court for the Southern District of New York, captioned *United States v. Madoff*, No. 08 CV 2735 (the "Criminal Action").[3] Also on December 11, 2008 (the "Filing Date"),[4] the Securities and Exchange

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[3] On March 10, 2009, the criminal case was transferred to Judge Denny Chin in the United States District Court for the Southern District of New York and was assigned a new docket number, No. 09 CR 213 (DC).

[4] Section 78*lll*(7)(B) of the Securities Investor Protection Act ("SIPA"), states that the filing date is "the date on which an application for a protective decree is filed under section 78eee(a)(3)," except where the debtor is the subject of a proceeding pending before a United States court "in which a receiver, trustee, or liquidator for such debtor has been appointed and such proceeding was commenced before the date on which such application was filed, the term 'filing date' means the date on which such proceeding was commenced." Section 78*lll*(7)(B). Thus,

Commission ("SEC") filed a complaint in the United States District Court for the Southern District of New York (the "District Court") against defendants Bernard L. Madoff and BLMIS (together, the "Defendants") (Case No. 08-CV-10791) (the "SEC Action").

On December 15, 2008, pursuant to section 78eee(a)(4)(A) of SIPA, the SEC consented to a combination of the SEC Action with an application of the Securities Investor Protection Corporation ("SIPC"). Thereafter, pursuant to section 78eee(a)(3) of SIPA, SIPC filed an application in the District Court alleging, *inter alia*, that BLMIS was not able to meet its obligations to securities customers as they came due and, accordingly, its customers needed the protection afforded by SIPA.

On that date, the District Court entered the Protective Decree, to which BLMIS consented, which, in pertinent part:

1. appointed the Trustee for the liquidation of the business of the Debtor pursuant to section 78eee(b)(3) of SIPA;

2. appointed Baker & Hostetler, LLP ("B&H") as counsel to the Trustee pursuant to section 78eee(b)(3) of SIPA; and

3. removed the case to this Court pursuant to section 78eee(b)(4) of SIPA.

On March 12, 2009, Madoff pled guilty to an 11-count criminal indictment filed against him. At the March 12, 2009 Plea Hearing, Madoff admitted that he "operated a Ponzi scheme through the investment advisory side of [BLMIS]." *See United States v. Madoff*, No. 09 CR 213 (DC), Docket No. 57, Plea Hr'g Tr. at 23:14-17. In pleading guilty to the crimes he committed, Madoff admitted that since at least the early 1990's the investment advisory business of BLMIS was used to operate a Ponzi scheme.[5] *See* Allocution at p. 2. On June 29, 2009, Madoff was

even though the Application for a protective decree was filed on December 15, 2008, the Filing Date in this action is on December 11, 2008.

[5] The Trustee is investigating whether the fraud at BLMIS extends back further than the early 1990's.

sentenced to 150 years for his crimes.

### B. The Ponzi Scheme

Madoff founded BLMIS in 1960. Until his arrest on December 11, 2008, Madoff was the sole member of BLMIS and its chairman. (*See* Declaration of Matthew Greenblatt, *hereinafter* "Greenblatt Decl." at ¶ 6). BLMIS had its principal place of business in New York and engaged in three primary types of business: market making, proprietary trading and investment advisory services. BLMIS was registered with the SEC as a broker-dealer and beginning in 2006 as an investment adviser. Pursuant to such registration as a broker-dealer, BLMIS was a member of SIPC.

Madoff solicited billions of dollars under false pretenses and failed to invest investors' funds as promised. Instead, he deposited investors' funds in a bank account at J.P. Morgan Chase Manhattan Bank. *See* Allocution of Bernard L. Madoff, *United States v. Madoff*, No. 09 CR 213 (DC), Docket No. 50, at pg. 1. Madoff represented to clients and prospective clients that he would invest their money in shares of common stock, options and other securities and would, at their request, return profit and principal. *See* Allocution at pg. 1. As the world is now aware, no securities were purchased by Madoff for his customers.

By early December 2008, BLMIS generated client account statements for its nearly 7,000 customer accounts (the "November 30, 2008 statements). (Greenblatt Decl. ¶ 7). When added together, these statements erroneously showed that the customers of BLMIS had approximately $64.8 billion invested with BLMIS. *Id.* In reality, BLMIS had assets on hand worth a small fraction of that amount. *Id.* Madoff's massive Ponzi scheme imploded and came to an end on December 11, 2008, the date on which he was arrested.

### C. The Trustee and SIPA

As the Trustee appointed under SIPA, the Trustee has the job of recovering and distributing customer property to BLMIS's customers, assessing claims, and liquidating any other assets of the firm for the benefit of the estate and its creditors. Pursuant to section § 78fff-1(a) of SIPA, the Trustee has the general powers of a bankruptcy trustee in addition to the powers granted by SIPA. Pursuant to section 78fff(b) of SIPA, Chapters 1, 3, 5 and Subchapters I and II of Chapter 7 of the Bankruptcy Code are applicable to this case.

Consistent with his duties, the Trustee is in the process of marshalling BLMIS's assets, and the liquidation of BLMIS's assets is well underway. The Trustee has recovered more than $1 billion dollars in assets to date.

This Court entered the Claims Procedure Order on December 23, 2008, which, *inter alia*, specified the procedures for the filing, determination, and adjudication of claims against the Debtor(s) in this proceeding. The Claims Procedure Order provides that, pursuant to section 78fff-2(a)(2) of SIPA, all claims against BLMIS should be filed with the Trustee. The Claims Procedure Order provides for the written determination by the Trustee of customer and creditor claims, and allows any claimant who opposes the Trustee's determination to file an objection with this Court. Thereafter, the Trustee shall obtain a date and time for a hearing before this Court.

### D. Plaintiffs' Customer Claims Filed with the Trustee

In violation of the Claims Procedure Order, Plaintiffs filed a complaint against the Trustee on June 10, 2009, seeking declaratory relief and damages for breach of fiduciary duty. Plaintiffs seek the following declarations: (i) that the Trustee is bound to fix a customer's claim at the balance shown on the November 30, 2008 statement; (ii) that the Court void the Partial

Assignment and Release executed by Ebel; and (iii) that the Trustee is not entitled to seek recovery of preferences received within the 90 days prior to the Filing Date.

Ebel Accounts

Ebel had two customer accounts (an IRA account and an individual account) at BLMIS. With regard to her IRA account, BLMIS Account No. 1ZR318, Ebel filed a customer claim with the Trustee on February 17, 2009. (Greenblatt Decl. ¶ 12). Thereafter, on May 20, 2009, the Trustee sent Ebel a Notice of Trustee's Determination of Claim and a Partial Assignment and Release. (*Id.* at ¶ 13). Ebel's claim was allowed by the Trustee in the amount of $1,348,877.12, which reflected the amount of money deposited with BLMIS.[6] (*Id.*). The Notice of Trustee's Determination of Claim informed Ebel that upon execution of the Assignment and Release, the Trustee would make a partial satisfaction of the allowed claim by sending Ebel a check for $500,000, with the funds advanced by SIPC. Ebel executed the Partial Assignment and Release on May 27, 2009 (*Id.* at ¶ 15), and on June 2, 2009, the Trustee sent her a check in the amount of $500,000.00. (*Id.* at ¶ 16).

With regard to her second account, BLMIS Account No. 1ZB463, Ebel filed a customer claim with the Trustee on February 17, 2009. (*Id.* at ¶ 17). Thereafter, on May 22, 2009, the Trustee sent Ebel a Notice of Trustee's Determination of Claim and a Partial Assignment and Release. (*Id.* at ¶ 19). Ebel's claim was allowed by the Trustee in the amount of $2,290,387.49, which reflected the amount of money deposited with BLMIS less withdrawals. (*Id.*). The Notice of Trustee's Determination of Claim informed Ebel that upon execution of the Assignment and Release, the Trustee would make a partial satisfaction of the allowed claim by sending Ebel a check for $398,000.00, with the funds being advanced by SIPC. The reduction in the SIPC

[6] Ebel made no withdrawals from this account. (Greenblatt Decl. ¶ 14).

advance represented an offset of the $102,000.00 withdrawal from Ebel's account that cleared on September 16, 2008, within the 90 days prior to the Filing Date. (*Id.* at ¶ 21).

On June 9, 2009, Ebel was sent a second Notice of Trustee' Determination of Claim and a revised Partial Assignment, reflecting that Ebel could accept with $398,000 while reserving her rights as to the disputed portion of the SIPC advance. Thus, were Ebel to sign the revised Partial Assignment and Release, she would receive the undisputed portion of the SIPC advance immediately. (*Id.* at ¶ 22). Although the Trustee has exchanged several communications with Ebel's counsel in an effort to resolve these matters without the continuation of an adversary proceeding, Ebel has not executed the Partial Assignment and Release to date. (Sheehan Decl. ¶ 6).

<u>Peskin Account</u>

On February 23, 2009, Peskin filed a customer claim with the Trustee. (Greenblatt Decl. at ¶ 23). Peskin filed a second customer claim with respect to the same account on June 29, 2009. On July 16, 2009, the Trustee sent Peskin a Notice of Trustee's Determination of Claim and a Partial Assignment and Release, combining the two claims and treating them as a single claim. (*Id.* at ¶ 24). Peskin's combined claim was allowed by the Trustee in the amount of $2,310,191.25, which reflected the amount of money deposited with BLMIS, less subsequent withdrawals. (*Id.* at ¶ 25). The Notice of Trustee's Determination of Claim informed Peskin that upon execution of the Assignment and Release, the Trustee would make a partial satisfaction of the allowed claim by sending Peskin a check for $500,000, with the funds advanced by SIPC pursuant to section 78fff-3(a)(1) of SIPA. (*Id.*).

**E. The "Net Equity" of Plaintiffs' Accounts**

Plaintiffs and the Trustee appear to agree on the basic formula that is to be applied in

determining each customer accounts' claims, but disagree on the values that are used to populate the formula. That formula is:

$$\frac{\text{Amounts Recovered}}{\text{Total Amount of Allowed Claims}} \times \text{Individual Account's Allowed Claims}$$

The disagreement in the definition of "Allowed Claims" is the crux of Plaintiffs' dispute.

Plaintiffs seek a declaration that the Trustee is required to allow customer claims in the amount shown on the November 30, 2008 statement issued by BLMIS.[7] (*See, e.g.*, Complaint at ¶ 97). Because those customer statements issued by BLMIS were based on fictitious profits, the Trustee has disregarded them for purposes of this determination. Instead, the Trustee is allowing claims in the amounts that a customer actually deposited with BLMIS, less the amounts that the customer withdrew from the account, sometimes referred to as the "cash in/cash out" approach. These differences in definition affect both the total amount of allowed claims and each individual account's allowed claim.

The November 30, 2008 statements issued by BLMIS showed that the "value" of all customer accounts was $64.8 billion. (Greenblatt Decl. at ¶ 7). However, the total amount of funds deposited but not withdrawn from BLMIS was less than $20 billion. (*Id.* at ¶ 31). These amounts have been referenced in a variety of complaints filed by the Trustee, including those cited by Plaintiffs in their Complaint. (*See e.g.* Complaint at ¶ 12).

Using the approach advocated by Plaintiffs (the "Peskin Methodology"), each account's claim would be calculated as follows.

[7] To the extent that Plaintiffs are arguing that the November 30, 2008 statement is the only way to ascertain customer claims from the Debtors' books and records, Plaintiffs are incorrect. As an initial matter, the "books and records" of a brokerage are comprised of more than merely the last customer account statements. The Trustee is not limited to looking only at customer statements, but he may review all of the financial and corporate records of the Debtor available to him. Second, the plain terms of SIPA state that payments to customers may be paid "insofar as such obligations are ascertainable from the books and records of the debtor *or are otherwise established to the satisfaction of the Trustee*." Section 78fff-2(b) of SIPA. Finally, in a fraud case such as this, relying on the customer statements as the only source of "books and records" is a nonsensical proposition.

$$\frac{\text{Amounts Recovered}}{\$64.8 \text{ billion}} \times \text{Amount Shown on November 30 Statement}$$

The Trustee, on the other hand, has adopted a methodology (the "Trustee's Methodology") that treats an allowed claim based solely on the deposits less withdrawals, and each account's claim would be calculated as follows (assuming that the amount of allowed claims will reach $20 billion):

$$\frac{\text{Amounts Recovered}}{\$20 \text{ billion}} \times \text{Account's deposits less withdrawals}$$

Turning to the specific accounts here, Ms. Ebel has two accounts and Dianne and Roger Peskin shared one. The following table demonstrates the differences in each of these three accounts' value based on the Trustee's Methodology (actual monies deposited less money withdrawn) and the Peskin Methodology (the amount shown on the November 30, 2008 statements).

| | **Trustee's Methodology (Cash in/Cash out)** | **Peskin Methodology (November 30 Statement)** |
|---|---|---|
| Peskin Account 1CM948 | $2,310,191 | $3,247,368 |
| Ebel Account 1ZR318 | $1,348,877 | $2,546,022 |
| Ebel Account 1ZB463 | $2,290,387 | $4,729,125 |

Obviously, by dint of the Ponzi scheme, Plaintiffs' November 30, 2008 statements are greater than the net equity in each account. Yet, for purposes of determining claims, Plaintiffs are better situated when net equity is calculated utilizing the Trustee's Methodology, as detailed in the charts below.

| **Ebel Account 1ZB318** | |
|---|---|
| **Using Peskin Methodolgy** | Amounts Recovered / $64.8 billion x $2,546,022 |
| For each $1 billion | $1 billion / $64.8 billion x $2,546,022 = **$39,290.46** |
| **Using Trustee's Methodology** | Amounts Recovered / $20 billion x $1,348,877 |
| For each $1 billion | $1 billion / $20 billion x $1,348,877 = **$67,443.86** |
| **Result:** | The Trustee's Methodology provides Ebel Account 1ZB318 an amount **172%** of the amount provided under the Peskin Methodology |

| **Ebel Account 1ZB463** | |
|---|---|
| **Using Peskin Methodolgy** | Amounts Recovered / $64.8 billion x $4,729,125 |
| For each $1 billion | $1 billion / $64.8 billion x $4,729,125 = **$72,890.32** |
| **Using Trustee's Methodology** | Amounts Recovered / $20 billion x $2,290,387 |
| For each $1 billion | $1 billion / $20 billion x $2,290,387 = **$114,519.37** |
| **Result:** | The Trustee's Methodology provides Ebel Account 1ZB463 an amount **157%** of the amount provided under the Peskin Methodology |

| **Peskin Account 1CM948** | | |
|---|---|---|
| **Using Peskin Methodolgy** | Amounts Recovered / $64.8 billion x $3,247,368 | |
| For each $1 billion | $1 billion / $64.8 billion x $3,247,368 = | **$50,113.70** |
| **Using Trustee's Methodology** | Amounts Recovered / $20 billion x $2,310,191 | |
| For each $1 billion | $1 billion / $20 billion x $2,310,191 = | **$115,509.56** |
| **Result:** | The Trustee's Methodology provides Peskin Account 1CM948 an amount **230%** of the amount provided under the Peskin Methodology | |

## ARGUMENT

### I. THE COURT SHOULD DISMISS THE COMPLAINT PURSUANT TO RULE 12(b)(6) BECAUSE IT VIOLATES THE PROCEDURES APPROVED BY THIS COURT

Although the Trustee also is moving to dismiss for lack of subject matter jurisdiction, that is admittedly a more complex argument which requires additional analysis. Here, there is a much more basic reason for dismissal of the Complaint. In this case, Plaintiffs brought an adversary proceeding in violation of the Claims Procedure Order and the claims process envisioned by SIPA and the Bankruptcy Code. Plaintiffs can make the same arguments, assert the same facts, and attain the exact same relief from this Court, if ultimately warranted, under the Claims Procedure Order. On that basis alone, the Complaint should be dismissed. Nonetheless, if Plaintiffs are not required to abide by the Claims Procedure Order to assert objections to the Trustee's determinations of their claims, certain of Plaintiffs' requests for declaratory judgment as well as their cause of action for breach of fiduciary duty fail to state a claim upon which relief can be granted, and should be dismissed.

### A. Standard of Review Under Rule 12(b)(6)

The standard of review for a motion to dismiss is well known – a complaint may be dismissed "if the allegations, taken as true, show the plaintiff is not entitled to relief." *Jones v. Bock*, 549 U.S. 199, 215 (2007); Fed. R. Civ. P. 12(b)(6). A motion to dismiss should be granted when it is beyond doubt that plaintiff can prove no set of facts entitling him to relief. *LaSala v. E*Trade Secs. LLC*, No. 05 Civ. 5869 (SAS), 2005 U.S. Dist. LEXIS 25880, at *14 (S.D.N.Y. Oct. 28, 2005). "Conclusory allegations or legal conclusions masquerading as factual conclusions will not suffice to [defeat] a motion to dismiss." *Smith v. Local 819 I.B.T. Pension Plan*, 291 F.3d 236, 240 (2d Cir. 2002) (internal citation omitted); *see also Bell Atlantic Corp. v. Twombly,* 550 U.S. 544 (2007) (holding that plaintiffs must plead "enough facts to state a claim to relief that is plausible on its face"). Dismissal of a complaint is warranted if, assuming the truth of the factual allegations of the plaintiff's complaint, there is a dispositive legal issue which precludes relief. *Neitzke v. Williams*, 490 U.S. 319, 326-327 (U.S. 1989) (citations omitted) (superseded on other grounds).

### B. Plaintiff's Attempts to Obtain Preferential Treatment Of Its Claim By Ignoring This Court's Order Should Be Dismissed

The Claims Procedure Order establishes an orderly procedure for the resolution of claims against the Debtors. Under the Claims Procedure Order, and consistent with SIPA and the Bankruptcy Code, all claims by customers must be filed with the Trustee. Order at 2; SIPA at §78fff-2(a)(2). The Trustee satisfies customer claims by distributing customer property supplemented by SIPC advances. Order at 5; SIPA at §78fff-2(b). If a claim is not supported by the Debtor's books and records or otherwise established to the Trustee's satisfaction, he may deny it and must notify the claimant of the determination in writing. If the claimant does not oppose the determination, that determination is deemed approved by the Court and binding on

the Claimant. If any opposition is filed, the Trustee obtains a hearing date and notifies the claimant of the date, time, and place of the hearing. Order at 6-7. Where appropriate, the Trustee may settle the claim. Order at 6.

The procedures mandated by the Court in the Claims Procedure Order comport with due process, SIPA, and the Bankruptcy Code. Unsurprisingly, the procedures employed in this liquidation proceeding are not novel. Rather, they have been consistently approved and applied in SIPA proceedings at least since 1975. *Secs. Investor Prot. Corp. v. Saxon Secs. Corp.*, No. 75 Civ. 377 (RJW), 1975 U.S. Dist. LEXIS 14757 (S.D.N.Y. 1975) (entering claims procedure order substantially similar to that entered herein); *see also Secs. Investor Prot. Corp. v. Stratton Oakmont, Inc.*, 229 B.R. 273, 275 (S.D.N.Y. 1999) (detailing claims process and relevant order substantially similar to that herein); *In re A.R. Baron Co., Inc.*, 226 B.R. 790, 792-93 (S.D.N.Y. 1998) (same); *In re Adler Coleman Clearing Corp.*, 211 B.R. 486 (S.D.N.Y. 1997) (same).

Plaintiffs' counsel has complied with the Claims Procedure Order on behalf of the account in which she has an interest as well as in her capacity as an attorney with respect to the account of another customer. In addition, the Trustee has received five other objections to claims determinations to date - thus, the required procedure is clearly not difficult to comply with. Nonetheless, showing contempt for the Claims Procedure Order, Plaintiffs come directly to this Court seeking resolution of issues related to their customer claims that have been submitted to the Trustee. Thus, all of the legally cognizable claims raised herein[8] can be resolved through the claims process, as specifically set forth in this Court's Claims Procedure Order, consistent with SIPA and the Bankruptcy Code. *See, e.g., In re Williams*, 392 B.R. 882

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[8] The claims procedure process is generally not used to assert claims for breach of fiduciary duty against the Trustee, which is the only cause of action other than declaratory relief relating to their customer claims that the Plaintiffs have sought. The Trustee submits, however, that this claim is also deficient under Rule 12(b)(6), discussed *infra*.

(M.D. Fla. 2008) (holding adversary proceeding was needless as it involved nothing more than objection to claim, contrary to scheme established by Congress to deal with creditor and debtor relationships). Plaintiffs should not be permitted to circumvent the Claims Procedure Order and bring an adversary proceeding in contravention of this Court's Claims Procedure Order and the controlling statutory scheme.

When faced with these precise facts, the United States District Court for the District of New Jersey granted the Trustee's motion to dismiss the adversary proceeding. In *In re Bevill, Bresler & Schulman, Inc.*, No. 85-1728 (D.N.J.) (Debevoise, J.), a creditor filed a complaint against the SIPA Trustee, seeking declaratory judgment to establish that the creditor was a customer under SIPA and therefore entitled to customer status. The Trustee moved to dismiss the complaint. The court issued an order dismissing the complaint and directing the Trustee to "consider the merits of [the creditor's] claim in the normal course the claims process previously established in the [claims procedure] order." *See In re Bevill, Bresler & Schulman, Inc.*, No. 85-1728 (D.N.J. May 22, 1989) (a copy of which is submitted herewith, *see* Sheehan Decl. ¶ 4).[9]

The Court should do the same here. The proper procedure for obtaining the relief Plaintiffs seek is by filing customers claims with the Trustee – which Plaintiffs have done – and then filing an objection to the Trustee's determination if the Plaintiffs feel the claims are wrongly decided. There is absolutely no sound basis for instituting an adversary proceeding. The benefits to the estate, not to mention to other injured BLMIS customers, of requiring Plaintiffs to adhere to the procedures set forth in the Claims Procedure Order plainly outweigh any benefits to

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[9] In light of the clear statutory scheme, few plaintiffs have acted as brazenly as Plaintiffs have here, resulting in a paucity of case law directly passing on this point within the context of SIPA liquidations. The order dismissing the complaint in *In re Bevill* is not reported. Nonetheless, the procedural history detailed above is discussed in a subsequent opinion, a copy of which has been provided to the Court herein.

Plaintiffs in pursuing this action.[10] Conversely, if this proceeding is allowed to go forward, the Trustee will have to divert substantial estate resources to the task of defending against this and similar cases in court, while litigating with customers and creditors these precise issues (and others) within the confines of the Claims Procedure Order. This attempt by Plaintiffs to alter the priority of their claims in an effort to jump the line is clearly improper and fundamentally unfair.

Moreover, allowing this action to proceed invites a "chaotic race to the courthouse" by other customers. *See Secs. Investor Prot. Corp. v. S.J. Salmon & Co.*, No. 72 CV 560 (Bankr. S.D.N.Y. June 1, 1972) (a copy of which is submitted herewith, *see* Sheehan Decl. ¶ 5). Indeed, the Trustee has received over 15,000 claims – if each customer decided to file a lawsuit instead of an objection to their claim, as Plaintiffs have here, the process of adjudicating claims and winding up the estate would be unwieldy and require unimaginable judicial resources.

Aside from the equitable and practical reasons for requiring Plaintiffs to adhere to the Court-mandated claims process, the Court has an interest, if not a duty, in ensuring that its orders are followed by parties under its jurisdiction. As recently noted by the United States Supreme Court, "where the plain terms of a court order unambiguously apply . . . they are entitled to their effect." *Travelers Indem. Co. v. Pearlie Bailey*, 129 S. Ct. 2195, 2009 U.S. LEXIS 4237, at **109 (2009). Indeed, "unless and until a clear an unambiguous order is amended or vacated . . . a court must adopt, and give effect to, [the order's] plain meaning." *Negron-Almeda v. Santiago*, 528 F.3d 15, 15 (1st Cir. 2008) (citing *United States v. Spallone*, 399 F.3d 415, 421 (2d Cir. 2005)). The Claims Procedure Order plainly applies to the Plaintiffs' claims. The action should be dismissed and Plaintiffs should be required to adhere to the claims determination process

[10] As discussed, *infra*, pursuing this action does not, as a factual matter, benefit Plaintiffs.

approved by the Court.[11]

### C. Plaintiffs' Claim That The Trustee Is Not Entitled To Seek Recovery of Preferences Is Deficient As A Matter of Law And Should Be Dismissed[12]

The Trustee, pursuant to his appointment under SIPA, is charged with recovering and distributing customer property to BLMIS customers. The Trustee is in the process of marshalling the assets of BLMIS, but such assets will be insufficient to reimburse the customers of BLMIS for the billions of dollars that they invested with BLMIS over the years. As such, the Trustee must use his authority under SIPA and the Bankruptcy Code to pursue recovery from customers who received preferences to the detriment of other defrauded customers whose money was eviscerated by the Ponzi scheme. Plaintiffs' assertion that the Trustee is not entitled to seek recovery of preferences ignores the plain language of both statutes.

On September 15, 2008, within the 90 days of the Filing Date, Ebel withdrew $102,000 from her BLMIS account (the "Preference Period Transfer"). (*See* Complaint at ¶ 55). At all times relevant hereto, Plaintiffs maintained accounts with BLMIS. Accordingly, at the time of the Preference Period Transfer, Ebel was a "creditor" of BLMIS within the meaning of sections 101(10) of the Bankruptcy Code and 78fff-2(c)(3) of SIPA.

The Preference Period Transfer constitutes a transfer of an interest of BLMIS in property within the meaning of sections 101(54) of the Bankruptcy Code and 78fff-2(c)(3) of SIPA. There is no dispute that the Preference Period Transfer was made to, or for the benefit of, Ebel.

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[11] Ms. Ebel's time period for filing an objection has run. The Trustee requests, however, that this adversary proceeding be converted into an objection on her behalf, which would be deemed filed the date of the filing of the adversary proceeding.

[12] Although the Complaint contains allegations regarding preferences relating to the Peskins' account, the Notice of Trustee's Determination of Claim reflects that they received the full SIPC advance. (Greenblatt Decl. ¶ 26).

The Preference Period Transfer was made on account of an antecedent debt owed by BLMIS to Ebel before such transfer was made for amounts Ebel invested with BLMIS.

Given the vast disparity between the assets of BLMIS and its liabilities, there is no doubt that BLMIS was insolvent at the time of the Preference Period Transfer and that the Preference Period Transfer allowed Ebel to receive more than she would receive if: (i) the BLMIS case was a case under chapter 7 of the Bankruptcy Code, (ii) the transfers had not been made, and (iii) Ebel received payment of such debt to the extent provided by the provisions of the Bankruptcy Code. As a result, the Trustee is entitled to avoid the Preference Period Transfers pursuant to section 547(b) of the Bankruptcy Code and recover the Preference Period Transfers or the value thereof from Ebel.

Despite Plaintiffs' conclusory assertions to the contrary, the fact that the BLMIS proceeding is a SIPA proceeding has no bearing on the Trustee's right to pursue preferences. Section 78fff-1(a) of SIPA provides the Trustee with the general powers of a bankruptcy trustee in a case under the Bankruptcy Code *in addition* to the powers granted by SIPA. In fact, section 78fff-2(c)(3) of SIPA explicitly provides that the Trustee may recover "any property transferred by the debtor, which, except for such transfer, would have been customer property."[13] *See* Section 78fff-2(c)(3) of SIPA. Thus, it is well within the Trustee's authority to commence preference actions in an attempt to maximize recoveries for all of the defrauded customers of BLMIS. As such, Plaintiffs' request for declaratory judgment on this basis is devoid of merit, and should be dismissed.

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[13] For purposes of avoidance actions, the transferred property at issue is deemed to be property of the debtor under the fraudulent conveyance and preference sections of the Bankruptcy Code. The customer who receives such fraudulent conveyance and preferences is "deemed to have been a creditor." However, when the property at issue is recovered and brought back into the estate, it is "treated as customer property." *See* section 78fff-2(c)(3) of SIPA.

Moreover, Plaintiffs' allegations that the property recovered by the Trustee using his avoidance powers under SIPA and the Bankruptcy Code will not go into the fund of customer property for the benefit of all customers but will instead reduce SIPC's obligations to customers, and will therefore benefit the brokerage industry, is incorrect. In this proceeding, pursuant to section 78fff-3(a)(1) of SIPA, SIPC is advancing to the Trustee monies up to $500,000 per customer's net equity, without regard to any subsequent offset by the Trustee. Where the Trustee has offset any preferential transfers received by the customer from the SIPC advance, such funds are placed into the fund of customer property for the benefit of *all* customers of BLMIS.

### D. Plaintiffs' Claim For Breach of Fiduciary Duty is Legally Deficient And Should Be Dismissed

Similar to their other claims, Plaintiffs' cause of action for breach of fiduciary duty against the Trustee also fails as a matter of law. For purposes of a fiduciary duty claim, the extent of a SIPA trustee's potential liability in a SIPA liquidation is the same as that of a chapter 7 bankruptcy trustee. *In re Adler*, No. 95-08203, 1998 Bankr. LEXIS 1076, at *29-30 (S.D.N.Y. Aug. 25, 1998) (citation omitted), *aff'd*, 2000 U.S. App. LEXIS 14008 (2d Cir. Mar. 13, 2000). A SIPA trustee's primary duty, like that of a chapter 7 trustee, "is not to any individual creditor or even any particular class of creditors, but to the estate as a whole" and accordingly "the trustee's duty to the SIPA estate as a whole clearly prevails over the interests of any single customer." *Id.* at *49-50.

In *Adler*, a customer sued the SIPC trustee for allegedly refusing to release certain securities the customer held at an account with the debtor wrongfully and in bad faith. *Id*. at *1-12. The Court found that plaintiff's claim was dependant on a finding that the trustee owed an individual plaintiff a greater duty than the duty owed the estate at large. *Id.* at 50. The *Adler*

Court further explained that this proposition was, obviously, conceptually at odds with, *inter alia*, the power of a trustee to avoid transfers. *Id*. at 50.

Plaintiffs' claim demanding the use of their own interpretation of "net equity" is essentially a request for the Trustee to act in a way that will be to the detriment of other customers of the estate (not to mention themselves)[14] who will benefit under the Trustee's interpretation of net equity. At least preliminarily, the Trustee is well within his rights and duties in the exercise of discretion given to him by Congress.

Indeed, a SIPA Trustee is "immune from suit for personal liability for acts taken as a matter of business judgment when acting in accordance with statutory or other duty or pursuant to court order." *In re Adler,* 1998 Bankr. LEXIS 1076, at *29-30. Being akin to a chapter 7 bankruptcy trustee, the SIPA trustee "is not liable in any manner for mistakes in judgment where discretion is allowed." *In re Adler,* 1998 Bankr. LEXIS 1076, at *29-30 (internal quotation omitted); *see also In re Smith*, 400 B.R. 370, 377-378 (Bankr. E.D.N.Y. 2009) (involving a chapter 7 trustee). Plaintiffs have pointed to no facts that rationally explain how the Trustee has done anything other than act in accordance with the best interests of the estate and within the discretion afforded to him under SIPA.

As a factual matter, Plaintiffs' claim also is entirely devoid of merit. Unfortunately, it appears that Plaintiffs have undertaken no factual investigation with respect to the calculations which underlie their own claims. These calculations are not difficult – indeed, the formula by which these determinations are made are well known, as are the differences between the Peskin Methodology and the Trustee's Methodology. Inasmuch as the Trustee's Methodology provides

[14] See Section II, *infra*,, for an explanation of how – despite this request - Plaintiffs do not actually benefit from the net equity calculation they have requested.

Plaintiffs with a *greater* amount than the Peskin Methodology, as a factual matter, the Trustee could not have breached a fiduciary duty even if one was owed.

The Plaintiffs' claim for breach of fiduciary duty is frivolous at best and should be dismissed.

## II. THIS COURT LACKS SUBJECT MATTER JURISDICTION OVER THE DECLARATORY JUDGMENT SOUGHT BECAUSE NO ACTUAL CONTROVERSY EXISTS BETWEEN PLAINTIFFS AND THE TRUSTEE

### A. Standard for 12(b)(1) Motion

Where a court lacks the statutory or constitutional power to adjudicate a case, it is properly dismissed under Rule 12(b)(1) for lack of subject matter jurisdiction. *Tasini v. New York Times Co., Inc.*, 184 F. Supp. 2d 350, 353 (S.D.N.Y. 2002). A plaintiff bears the burden of proving that jurisdiction is proper. *Id.*

In resolving a Rule 12(b)(1) motion that raises a facial challenge as to the sufficiency of the pleadings, the court must accept the plaintiff's material allegations as true. *Id.* Where the Rule 12(b)(1) motion raises a factual challenge, however, "no presumptive truthfulness attaches to the complaint's jurisdictional allegations; rather, the burden is on the plaintiff to satisfy the Court, as fact-finder, of the jurisdictional facts." *Guadagno v. Wallack Ader Levithan Assoc.*, 932 F. Supp. 94, 95 (S.D.N.Y. 1996), *aff'd*, 125 F.3d 844 (2d Cir. 1997). A court may look to evidence extrinsic to the pleadings if jurisdiction turns on a factual issue. *See United States v. Vasquez*, 145 F.3d 74, 80 (2d Cir. 1998); *Jaghory v. New York State Dept. of Educ.*, 131 F.3d 326, 329 (2d Cir. 1997).

This motion, to the extent it challenges the declaratory judgment sought with respect to the "net equity" issue, reflects a factual challenge to the Court's subject matter jurisdiction. Therefore, it is supported by declaration of Matthew Greenblatt as well as citations to exhibits

filed in connection with the same. The Court may consider and should resolve disputes of fact arising from the evidentiary submissions in ruling on the Trustee's motion to dismiss pursuant to Rule 12(b)(1).

**B. The Article III Requirement for a Declaratory Judgment Action**

A party seeking a declaratory judgment has the burden of showing that the court has jurisdiction. *See E.R. Squibb & Sons, Inc. v. Lloyd's & Cos.*, 241 F.3d 154, 177 (2d Cir. 2001). The Article III "case or controversy" requirement applies with equal force to actions under the Declaratory Judgment Act, which incorporates that standard by its requirement that an actual controversy exist between the parties. 28 U.S.C. § 2201(a); *see also Assoc. Indem. Corp. v. Fairchild Indus., Inc.*, 961 F.2d 32, 35 (2d Cir. 1992) ("like any other action brought in federal court, a declaratory judgment is available to resolve a real question of conflicting legal interests") (internal quotation omitted). If no actual case or controversy exists between the parties regarding the subject on which declaratory judgment is sought, the court lacks subject matter jurisdiction. *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 239-40 (1937).

"In order to achieve the status of a case or controversy, a dispute must exist between two parties having adverse legal interests." *S. Jackson & Son v. Coffee, Sugar & Cocoa Exch.*, 24 F.3d 427, 431 (2d Cir. 1994). "If the declaration sought would constitute nothing more than a bald declaration of legal rights unrelated to any actual, live dispute between adverse parties - - in other words, an advisory opinion - - the Court lacks authority to issue declaratory relief. *Brunson v. Clark*, No. 94 Civ. 9256 (JFK), 1996 U.S. Dist. LEXIS 14459, at *7 (S.D.N.Y. Oct. 1, 1996); *see also Flast v. Cohen*, 392 U.S. 83, 96 (1968) (noting that the "oldest and most consistent thread in the federal law of justiciability is that the federal courts will not give advisory opinions").

In order to establish the constitutional requirements of standing, Plaintiffs must show (1) injury in fact, (2) a causal nexus between the complained-of conduct and the injury, and (3) redressability of the injury. *See, e.g., Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992). Moreover, prudential limitations require Plaintiffs to demonstrate that they are the "proper proponents of the particular legal rights on which they base their suit." *Singleton v. Wulff*, 96 S. Ct. at 2873. In accordance with the latter principle, plaintiffs should assert their own legal rights and interests, rather than those of third parties. *Daly v. Morgenthau*, No. Civ. 3299 (LMM), 1998 U.S. Dist. LEXIS 19095, at *8 (S.D.N.Y. 1998).

### C. Plaintiffs Cannot Show That They Personally Suffered Injury Within the Meaning of Article III

Plaintiffs have failed to establish that they have standing to seek a declaration from this Court regarding the net equity issue.[15] The injury-in-fact requirement "demands that the court inquire whether the relief sought by plaintiff would be likely to redress his asserted injury." *Hoffman v. DiFalco*., 424 F. Supp. 902, 907 (S.D.N.Y. 1976); *see also Secs. Investor Prot. Corp. v. Bernard L. Madoff Invest. Secs.*, No. 08-0179 (BRL), 2009 Bankr. LEXIS 446, at *5 (Bankr. S.D.N.Y. Feb. 24, 2009) ("a litigant must have suffered some actual injury that can be redressed by a favorable judicial decision"). Plaintiffs suffer no injury here.

The facts here demonstrate that Plaintiffs are not within the category of customers that could be injured by the Trustee's interpretation of net equity. To the contrary, the Plaintiffs benefit from the adoption of the Trustee's Methodology and the rejection of the Peskin Methodology. Indeed, Plaintiffs' counsel explicitly recognized this when discussing the status of

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[15] Plaintiffs have also sought a declaration that Ebel is entitled to void the partial assignment and release she executed with regard to Account No. 1ZR318, alleging that the Trustee is not entitled to require her to sign a release as a condition of receipt of property. As this is contradicted by the plain terms of SIPA, this argument is deficient as a matter of law. *See* Section 78fff-2(b) of SIPA ("Any payment or delivery of property pursuant to this subsection may be conditioned upon the trustee requiring claimants to execute . . . releases[] and assignments").

her own account.[16] (*See* Sheehan Decl. ¶ 6). Thus, a ruling in Plaintiffs' favor is actually to their personal detriment, rather than redressing an "injury" as they have alleged. Simply put, Plaintiffs will not suffer an "injury" if the Trustee's Methodology is adopted by the Court.

The Trustee does not dispute that some BLMIS customers may be injured by his interpretation of "net equity" (*e.g.*, individuals that withdrew more from their BLMIS accounts than they deposited). It is undisputable, however, that Plaintiffs are not among this group. In order to have standing, a plaintiff must always have suffered "a distinct and palpable injury to himself that is likely to be redressed if the requested relief is granted." *Gladstone, Realtors v. Village of Bellwood*, 441 U.S. 91, 100 (1979) (internal quotations omitted); *see also Daly v. Morgenthau*, No. Civ. 3299 (LMM), 1998 U.S. Dist. LEXIS 19095, at *8 (S.D.N.Y. 1998) (holding judicial power is restricted to those litigants who can show they personally suffered injury). Where a plaintiff cannot show any personal injury to herself, courts routinely hold that that plaintiff fails to establish standing. *Tasini v. New York Times Co., Inc.*, 184 F. Supp. 2d 350, 353 (S.D.N.Y. 2002); *see also Old Saybrook Police Union C.O.P.S. Local #106, Inc. v. Mosca*, No. 3:08-cv-01025 (JCH), 2009 U.S. Dist. LEXIS 8544, at * (D. Conn. Feb. 3, 2009) (holding plaintiff had no standing where it was not injured by alleged improper distribution of assets).

Inasmuch as Plaintiffs cannot demonstrate that they personally suffered an injury, they lack standing to assert a claim. Despite the facial allegations of the Complaint, in fact, Plaintiffs are not adverse to the Trustee with regard to this issue. Because Plaintiffs are not harmed by the Trustee's Methodology, but are in fact better served by the application of the Trustee

[16] It is unclear whether Plaintiffs' counsel has fully explained this distinction to her clients. More troubling, Plaintiffs' counsel has filed proofs of claim on behalf of individuals that would benefit from the Peskin Methodology. Here, she represents individuals that would suffer from the application of the Peskin Methodology. Obviously, this is a conflict. More important, Plaintiffs' counsel has filed an objection to the claims determination for an account in which she has an interest. Counsel is clearly representing clients with differing interests. Likewise, Counsel has a personal interest in the outcome which is different than the one she is advocating here. This issue was raised to both Counsel and her firm more than thirty days ago.

Methodology to their customer claims, they cannot assert a legally cognizable injury to establish Article III standing to bring a claim for declaratory relief.

### D. Plaintiffs Cannot Seek Relief On Behalf Of Other Customers

To the extent that Plaintiffs bring this action on behalf of other customers who would be prejudiced by the Trustee's interpretation of net equity, that effort is equally futile. Courts have held that "[m]ere interest in, or concern over, a [] defendant's acts - - no matter how deeply felt - - is insufficient to demonstrate injury in fact." *Evans v. Lynn*, 537 F.2d 571 (2d Cir. 1976); *see also Hoffman v. DiFalco*, 424 F. Supp. 902, 905 (S.D.N.Y. 1976). Thus, even if other customers will be injured by the Trustee's interpretation of net equity, that does not establish standing for these particular Plaintiffs to seek declaratory relief.

Even assuming that Plaintiffs could satisfy the criteria of constitutional standing, which they cannot, they must also satisfy the prudential standing requirements in order to invoke the rights of third parties. Namely, Plaintiffs must show "(1) 'a close relation to the third party' and (2) 'some hindrance to the third party's ability to protect his or her own interests.'" *Tasini v. New York Times Co., Inc.*, 184 F. Supp. 2d 350, 357 (S.D.N.Y. 2002) (quoting *Powers v. Ohio*, 499 U.S. 400, 411 (1991)). Plaintiffs have not even alleged that they can meet either requirement. As discussed above, there is no hindrance to the ability of third parties to protect their interests, as evidenced by the filing of objections to customer claims that raise this precise issue. Because Plaintiffs cannot meet the constitutional or prudential standing requirements, this Court should dismiss their claim for declaratory relief for lack of subject matter jurisdiction. *See Tasini v. New York Times Co., Inc.*, 184 F. Supp. 2d 350, 357 (S.D.N.Y. 2002) (dismissing complaint where plaintiff failed to meet constitutional or prudential standing requirements).

## III. IN THE ALTERNATIVE, CERTAIN PARAGRAPHS OF THE COMPLAINT SHOULD BE STRICKEN PURSUANT TO RULE 12(f)

Given the manifold infirmities in Plaintiffs' Complaint, it appears that the Complaint was been filed for purposes other than actually achieving the relief it seeks. This conclusion is buttressed by the fact that Plaintiffs' Complaint contains various statements that are purely legal, and others that are merely *ad hominem* attacks aimed at the Trustee. To the extent that this Court does not grant Plaintiffs' motion to dismiss, this Court should strike those portions of Plaintiffs' Complaint that are immaterial, irrelevant, and scandalous.

### A. Standards of Review Under Rules 8 and 12(f)

Rule 8 of the Federal Rules of Civil Procedure requires that pleadings contain "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). The pleading should be "plain" by stating relevant facts and not conclusions. *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, 218 F.R.D. 76, 77 (S.D.N.Y. 2003). The pleading should be direct, meaning that allegations should be relevant to the causes of action. *Id.* "Complaints which ramble, which needlessly speculate, accuse and condemn, and which contain circuitous diatribes far removed from the heat of the claim do not comport with these goals and this system" and must be dismissed. *Prezzi v. Berzak*, 57 F.R.D. 149, 151 (S.D.N.Y. 1972). Such pleadings may be dismissed in their entirety, or the court may strike the offending paragraphs under Rule 12(f). *See Impulsive Music v. Pomodoro Grill, Inc.*, 2008 U.S. Dist. LEXIS No. 08-10916, 94148, at * (W.D.N.Y. Nov. 19, 2008) ("courts will only strike those portions that are improper").

Pursuant to Rule 12(f) of the Federal Rules of Civil Procedure, a court may strike from a pleading "any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." *See Global View Ltd. Venture Capital v. Great Cent. Basin Exploration*, 288 F. Supp.

2d 473 (S.D.N.Y. 2003) (citing Fed. R. Civ. P. 12(f)). The word "scandalous" as used in the context of Rule 12(f), generally refers to "any allegation that unnecessarily reflects on the moral character of an individual or states anything in repulsive language that detracts from the dignity of the court." *See* 2 Moore's Federal Practice § 12.37[3] at 12-97 (3d ed. 2007). Allegations are "impertinent" within the definition of Rule 12(f) where they do "not pertain to and are not necessary to resolve the issues in question." *In re Montagne*, 2009 Bankr. LEXIS 60, at *11 (Bankr. D. Vt. Jan. 5, 2009). Although motions to strike are not favored, they may be granted where the allegations at issue serve no purpose except to "inflame the reader." *Morse v. Weingarten*, 777 F. Supp. 2d at 312, 319 (S.D.N.Y. 1991).

As discussed more fully above, Plaintiffs assert causes of action against the Trustee seeking declaratory relief and damages for breach of fiduciary duty. Plaintiffs need do little more than allege the facts relating to their customer accounts and the Trustee's determination of their customer claims, alleged duties owed by the Trustee to them, and a breach of those duties by the Trustee. The Complaint, however, alleges far more, even though these further allegations have no impact on the underlying claims.

For example, paragraph 106 of the Complaint states that the Trustee's "actions were taken in bad faith . . . in order to enrich the brokerage industry at the expense of Madoff's investors." (Complaint ¶ 106). Similarly, Plaintiffs allege that the Trustee "seeks to appropriate the money plaintiffs received within 90 days of December 15, 2008, not for the benefit of all investors but rather simply for the benefit of SIPC and the broker-dealers that SIPC represents." (Complaint ¶ 91). Although the Complaint is replete with variations on these themes, these examples suffice to convey the tenor of the allegations at issue.

Rather than individually list here each of the paragraphs that should be stricken, they can

be grouped into two broad categories.[17] First, the Complaint contains numerous citations to and paraphrasing of statutes, case law, legislative histories, and media reports. Second, many of the allegations in the Complaint improperly impugn the character of the Trustee, the nature of this liquidation proceeding, and SIPC, rather than advancing the merits of Plaintiffs' claims. Each of the offending paragraphs that fall within these categories are patently improper pleadings, and should be stricken.

With regard to citation to legal authority in pleadings, courts have stricken references to statutory provisions, case law, and legislative histories as improper. *See Nextel of New York, Inc. v. City of Mount Vernon*, 361 F. Supp. 2d 336, 340 (S.D.N.Y. 2005) (granting motion to strike all references to, *inter alia*, statutory provisions, case law and legislative histories). Such references are unnecessary to the "short and plain statement" required under Rule 8 and are prejudicial if they were ever reviewed by a jury. As the *Nextel* court noted, "[a]t any trial, it is the court's responsibility to instruct the jury on the applicable law, and Plaintiff's references thereto would interfere with the court's performance of its function." *Id.* Thus, paragraphs containing references to legal authority should be stricken from the Complaint.

The remaining improper allegations in the Complaint focus on the Trustee's alleged relationship to the brokerage industry, spurious allegations regarding the Trustee and SIPC, and the improper motives of each, none of which are related to the causes of action asserted. Inclusion of such allegations in the Complaint make the pleading a political statement at best – a tabloid story, at worst – neither of which should be permitted under the Federal Rules. Plaintiffs and their counsel are engaging in a transparent public relations ploy, bent on persuading the press

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[17] Referencing only some of the paragraphs does not deem the other paragraphs acceptable or admitted. Listed Exhibit D annexed to the declaration of David J. Sheehan, the Trustee has listed in bold each paragraph or portion thereof that should be stricken.

and the public that the Trustee is acting in bad faith, despite the absence of a shred of evidence to that effect. Such references are scandalous and serve no other purpose other than to cast a derogatory and prejudicial pale over the Trustee.

It is obvious that Plaintiffs included the inflammatory and impertinent material as part of counsel's ongoing publicity campaign against the Trustee and SIPC and should not be countenanced. *See In re Montagne*, 2009 Bankr. LEXIS 60, at *11 (Bankr. D. Vt. Jan. 5, 2009) (striking allegations directed at tainting the character of movant and not advancing claims). Courts have specifically instructed litigants to avoid "name calling" and instead require parties to allege facts that contribute to their substantive claims. *See Global View*, at 481 (noting complaints should avoid "name calling" and should instead advance substantive claims alleged).

Here, the Trustee's motion should be granted because the offending allegations have no bearing on the issues in the case, are inflammatory, and permitting the allegations to stand would result in prejudice to the Trustee. *See Koch v. Dwyer*, No. 98-civ-5519, 2000 WL 174945, (S.D.N.Y. Sept. 29, 2000); *Shahzad v. H.J. Myers & Co., Inc.*, 1997 U.S. Dist. LEXIS 1128, at *40 (S.D.N.Y. Feb. 6, 1997) (granting motion to strike where allegations served no purpose except to inflame the reader and that were of no probative value); *Red Ball Interior Demolition Corp.*, 908 F. Supp. 1226 At 1241-42 (holding motion to strike may be granted where allegations challenged are likely to prejudice movant). Complaints that ramble, needlessly speculate, accuse and condemn, do not comply with the Federal Rules of Civil Procedure, and a motion to strike is proper to pare down the allegations to a more appropriate pleading. *See, e.g., Levine v. County of Westchester*, 828 F. Supp. 238, 214 (S.D.N.Y. 1993).

## CONCLUSION

For each of the foregoing reasons, Plaintiffs' Complaint should be dismissed with prejudice.

Dated: New York, New York
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Respectfully submitted,

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