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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiff-Applicant,

v.

BERNARD L. MADOFF INVESTMENT SECURITIES LLC,

Defendant.

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

SIPA LIQUIDATION

(Substantively Consolidated)

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In re:

BERNARD L. MADOFF,

Debtor.

---X

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

Plaintiff,

v.

Adv. Proc. No. 10-04476

FRANITZA FAMILY LIMITED PARTNERSHIP, MANFRED FRANITZA REVOCABLE TRUST, NTC & CO., LLP, as former custodian of an Individual Retirement Accounts for the benefit of Manfred Franitza and Margrit Franitza, MANFRED FRANITZA, individually and in his capacities as General Partner of the Franitza

Family Limited Partnership and as Trustee and/or Beneficiary of the Manfred Franitza Revocable Trust, MARGRIT FRANITZA, individually and in her capacities as General Partner of the Franitza Family Limited Partnership and as Trustee and/or Beneficiary of the Manfred Franitza Revocable Trust, URTE FRANITZA-GOLDSTEIN, individually and as General Partner of the Franitza Family Limited Partnership, and KAREN FENNER, individually and as General Partner of the Franitza Family Limited Partnership,

Defendants.

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MEMORANDUM OF LAW IN SUPPORT OF
MOTION SEEKING A WITHDRAWAL OF REFERENCE

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

PRELIMINARY STATEMENT 1

BACKGROUND 1

ARGUMENT 5

POINT
THE REFERENCE SHOULD
BE WITHDRAWN 5

- **1. The Securities Investor Protection Act** 6
- **2. The Trustee's Interpretation of SIPA Conflicts with Federal and State Securities Laws as well as the Bankruptcy Code** 10
- **3. SLUSA** 16
- **4. Other Withdrawal of Reference Motions** 17

CONCLUSION 18

TABLE OF AUTHORITIES

CASES **PAGE**

Bear, Sterns Securities Corp. v. Gredd, 2001 WL 840187 (S.D.N.Y. July 25, 2001). 15

Chemtura Corp. v. U.S., 2010 WL 1379752 (S.D.N.Y. Mar. 26, 2010). 6

City of New York v. Exxon Corp., 932 F.2d 1020 (2nd Cir. 1991). 5

Eastern Airlines, Inc. v. Air Line Pilots Ass. (In re Ionosphere Clubs, Inc.), 1990 WL 5203(S.D.N.Y. Jan. 24, 1990). 6

Enron Power Mktg., Inc. v. Cal. Power Exch. Corp. (In re Enron Corp.), 2004 WL 2711101 (S.D.N.Y. Nov. 23, 2004). 6

In re Dana Corp., 379 B.R. 449 (S.D.N.Y. 2007). 5

In re Ionosphere Clubs, Inc., 922 F.2d 984 (2nd Cir. 1990). 5

In re Cablevision, 315 B.R. 818, 821 (S.D.N.Y. 2004). 15

In re Sharp Int'l Corp, 403 F.3d 43 (2nd Cir. 2005). 14

Picard v. HSBC Bank, et. al., 11 civ. 763 (S.D.N.Y. April 25, 2011). 6, 7, 8, 15, 16, 17

Picard v. JP Morgan Chase & Co., et. al., 11 Civ. 0913 (S.D.N.Y. May 23, 2011). 6, 8

STATUTES AND RULES

11 U.S.C. § 548. 14

11 U.S.C. § 544. 14

15 U.S.C. § 78fff-2. 14

15 U.S.C. §78bbb. 7

15 U.S.C. §77p. 16

17 C.F.R. §240.10B-10 (2010). 12

28 U.S.C.§157(d). 5, 8

59 Fed. Reg. 59,612, 59,613 59,614 (Nov. 17, 1994)
(to be codified at 17 C.F.R. pt. 240). 12

N.Y. Debt. & Cred. Law §272. 14

NASD Rule 2340. 12

NYSE Rule 409. 12

NYUCC § 8-501. 13

NYUCC § 8-503. 13

NYUCC § 8-102. 13

Rule 10b-10. 12

PRELIMINARY STATEMENT

This Memorandum of Law is submitted in support of the instant motion to withdraw the reference to the Bankruptcy Court with respect to the adversary proceedings identified in Exhibit A to the Declaration of David B. Bernfeld.[1] In each of theses cases, significant issues of non-bankruptcy federal law (including SIPA and other federal securities act statutes and regulations) will need to be resolved by the Court. Accordingly, the requirements for mandatory withdrawal of the reference are clearly met.[2]

For the reasons explained below, the motion should be granted under both the mandatory and discretionary provisions of the withdrawal of reference statute.

BACKGROUND

All of the adversary proceedings (the "Cases") which are the subject of this motion have been brought by the Trustee ostensibly within the broad umbrella of the SIPC liquidation proceedings of Bernard L. Madoff Investment Securities ("BLMIS") now pending in the Bankruptcy Court.

The Trustee has acknowledged that each Defendant in these Cases - every one of them - is an innocent victim of the massive fraud perpetrated by Madoff. None are alleged to have had actual knowledge of the fraud and none is claimed to have been complicit in the fraud.

When the fraud came to light, each Madoff customer obviously lost everything that he or she believed was in their Madoff account. Each, however, was somewhat comforted by the belief that they would at least receive a prompt SIPC advance to help them get back on their feet.

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[1] This firm represents the defendants set forth in the Bernfeld Declaration in each of the identified Adversary Proceedings (the "Defendants").

[2] The requirements for withdrawal of reference in the Court's discretion have also been satisfied.

But that belief was soon dashed - actually demolished - by the Trustee. He not only denied their claims for SIPC advances, he has now sued them in avoidance actions seeking awards calculated based upon withdrawals made over the life of the Defendants' accounts, in some cases, over the course of decades and multiple generations. Ironically, the Trustee has asserted that his authority to bring these actions and further victimize these Defendants, along with thousands of others like them, is purportedly derived from the Securities Investor Protection Act ("SIPA") - an act which, as set forth in its title, was specifically intended to *protect* innocent investors such as the Defendants.

The unstated purpose behind the Trustee's otherwise illogical position of going after the very victims he is mandated to protect and aid, is quite simple and transparent. First and foremost, the Trustee has acted to allow SIPC (and by extension the financial industry that funds it) to avoid paying approximately $1 billion in SIPC advances that should otherwise have been paid to victims like the Defendants and others similarly situated. (SIPC has done so in the wake of an unprecedented financial crisis catapulted by the Lehman failure and at a time SIPC was charging a mere $150 per year to its member-firms - leaving SIPC grossly underfunded.)

To accomplish this, the Trustee has fashioned a twisted definition of a customer's "net equity" under SIPA which wipes out all account statements and trade confirmations received by the customers and substitutes a new "history" consisting solely of deposits into and withdrawals from the account over the life of the account (and any accounts the Trustee arbitrarily deems to be related). That is how he converts victims who had positive balances on their final account statements into parties who are told they have negative balances on which they are now obliged to "make good."

For Madoff victims such as the Defendants, already in total shock over the loss of the monies they thought they had in their Madoff account, the additional consequences of the Trustee's actions have been devastating:

a. Over half of the Madoff account holders, were denied any SIPC advance - because under the Trustee's methodology, they suddenly had negative Net Equity in their accounts.

b. These customers then learned that under the Trustee's methodology, they would not be allowed to participate in the distribution of customer property recovered by the Trustee.

c. Even more devastating, they were also told that they actually *owed* significant moneys to the Trustee, in many cases in the millions of dollars, and if they couldn't or wouldn't pay, the Trustee would pursue them with devastating clawback actions.

Thus, these innocent parties were victimized in at least three separate ways:

a. First they were defrauded by Madoff and lost everything that was in their account when Madoff confessed.

b. They were victimized a second time when they were denied the SIPC advance that so many of them desperately needed to survive (and had every reasonable expectation they were entitled to).

c. They have now been victimized for a third time by these devastating clawback actions which demand huge sums of money from them (even though most have already suffered financial devastation as a result of Madoff's fraud).

All this despite the fact that even the Trustee acknowledges that these victims did absolutely nothing wrong.

The Trustee now seeks to extend the impact of his flawed Net Equity definition to these avoidance actions against innocent victims, such as the Defendants in the Cases which are the subject of this motion. Although he ostensibly seeks to avoid only withdrawals made during the six years prior to the filing of the BLMIS liquidation proceedings, the reality is quite different. In fact, by applying his "cash in/cash out" construct over the entire existence these accounts, he is effectively "recouping by disallowance" transactions which occurred and were recorded decades earlier - well beyond any applicable statute of limitations in order to claim that the Defendants received and kept monies "stolen" from unidentified "other people."

Remarkably, the Trustee asserts that he is authorized to do all of this under SIPA and that he is acting on behalf of other investors whose SIPC claims he has allowed.

As discussed in greater detail below, the Trustee's stated positions and the allegations made in the instant avoidance actions represent novel interpretations of SIPA which are contrary to the statute's plain language and the express purpose behind the legislation as well as other relevant non-bankruptcy federal and state laws. These actions raise serious issues under SIPA and these other non-bankruptcy federal law which will require significant interpretation by the Court. Under such circumstances, a withdrawal of the prior reference to the Bankruptcy Court is mandatory.

ARGUMENT

POINT

THE REFERENCE SHOULD BE WITHDRAWN

Federal District Courts have original jurisdiction over all bankruptcy cases and other civil proceedings arising under, in or relating to cases under Title 11. Although such cases are automatically referred to the Bankruptcy Court in the Southern District, the District Court can withdraw the reference of such a case either on its own motion and or on the motion of a party pursuant to 28 U.S.C.§157(d).

In relevant part, 28 U.S.C. §157(d) provides as follows:

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

28 U .S.C. § 157(d).

Thus, withdrawal is mandatory "... where substantial and material consideration of non-Bankruptcy Code federal statutes is necessary for the resolution of the proceeding." *In re Ionosphere Clubs, Inc.*, 922 F.2d 984, 995 (2nd Cir. 1990). Consideration has been held to be "substantial and material" where the case requires a "significant interpretation, as opposed to simple application, of federal laws apart from the bankruptcy statutes." *City of New York v. Exxon Corp.*, 932 F.2d 1020, 1026 (2nd Cir. 1991); *see also*, *In re Dana Corp.*, 379 B.R. 449, 453 (S.D.N.Y. 2007). This provision was intended to "assure that an Article Ill judge decides issues calling for more than routine application of [federal laws] outside the Bankruptcy Code." *Enron*

Power Mktg., Inc. v. Cal. Power Exch. Corp. (In re Enron Corp.), 2004 WL 2711101, at *2 (S.D.N.Y. Nov. 23, 2004) (*quoting*, *Eastern Airlines, Inc. v. Air Line Pilots Ass. (In re Ionosphere Clubs, Inc.)*, 1990 WL 5203, at *5 (S.D.N.Y. Jan. 24, 1990)). The need for mandatory withdrawal is highlighted where a matter of first impression is presented. *See*, *Chemtura Corp. v. U.S.*, 2010 WL 1379752, at *1 (S.D.N.Y. Mar. 26, 2010) ("Where matters of first impression are concerned, the burden of establishing a right to mandatory withdrawal is more easily met.").

As set forth below, the Cases all involve issues that will require significant interpretation of non-bankruptcy statutes, including issues of first impression.[3] Indeed, those issues predominate and will likely be dispositive of the claims. Accordingly, the reference to the Bankruptcy Court must be withdrawn and these Cases should be heard and determined in this Court.

1. <u>The Securities Investor Protection Act</u>.

As noted, the Defendants are innocent customers of BLMIS who, however, find themselves being effectively pursued as if they were thieves, and told they must "disgorge" the "stolen property" they allegedly received.

Although the Trustee claims SIPA authorizes him to act in this fashion, Defendants could not disagree more sharply. The fact is that the express language and legislative purpose of SIPA

[3] There have already been two decisions in this Court withdrawing reference in adversary proceedings brought in the Bankruptcy Court arising from the Madoff Liquidation. In *Picard v. HSBC Bank, et. al.*, 11 civ. 763 (S.D.N.Y. April 25, 2011) ("*HSBC*") and *Picard v. JP Morgan Chase & Co., et. al.*, 11 Civ. 0913 (S.D.N.Y. May 23, 2011) ("*JP Morgan*") the Court ruled that the substantial interpretation of statutes that are also required to be interpreted in the instant Cases mandated withdrawal of the reference. These decisions are annexed to the Bernfeld Declaration as Exhibits C and D for the Court's convenience.

is in direct contradiction to the Trustee's assertions of this claimed authority.

Thus, whether a SIPA Trustee has any authority under SIPA to pursue avoidance actions against innocent customers of a failed broker is a threshold issue in each of these Cases that will have to be judicially determined. Under the clear mandate of the withdrawal of reference statute, that determination is properly for this Court, not a Bankruptcy Judge.

Indeed, in two other withdrawal of reference applications arising out of the Madoff liquidation, this Court has granted the applications based on an explicit ruling that: (i) SIPA is a Securities Act statute, not a Bankruptcy Code enactment; and (ii) that significant issues under SIPA necessarily require withdrawal of the reference.[4] Thus, before any of these Cases can proceed, the Court must first determine whether SIPA can be used as the predicate for adversary proceedings against those who are the intended protected class under the statute. We submit that SIPA provides no authority for this brazen attempt by the Trustee to deprive innocent customers of their clear right, as a matter of law, to rely on the validity of their account statements and trade confirmations to reflect what they were owed by their broker.[5]

It is thus fair to state that whenever a significant SIPA issue is presented for resolution in a case before the Bankruptcy Court, a withdrawal of reference is invariably mandated. As this

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[4] *See, e.g.*, *HSBC*, Bernfeld Declration, Ex. C, p. 6 ["SIPA expressly provides that it shall be considered an amendment to, and section of, the Securities Exchange Act of 1934, and for this reason is codified in Title 15 (where securities laws are placed), rather than in Title 11 (where bankruptcy laws are placed). See 15 U.S.C. §78bbb ('Except as otherwise provided in this chapter, the provisions of the Securities Exchange Act of 1934 .. , apply as if this chapter constituted an amendment to, and was included as a section of, such Act.'). The reason for this language and placement is that SIPA is, first and foremost, concerned with the protection of securities investors (as its very title states), whether in or outside the bankruptcy context."]

[5] As discussed below, the Movant's status as creditors also prohibits these actions.

Court explained in a recent withdrawal of reference motion arising from the Madoff liquidation:

> A substantial issue under SIPA is therefore, almost by definition, an issue 'the resolution of [which] requires consideration of both Title 11 and other laws of the United States.'

HSBC, Bernfeld Declaration, Ex. C, pp. 6-7 (*quoting*, 28 U.S.C. § 157(d)). *See also*, *JP Morgan* ("Thus, an issue that requires significant interpretation of SIPA undoubtedly requires consideration of law outside Title 11"). The application of SIPA to avoidance actions in this context presents matters of first impression requiring "significant interpretation" of SIPA throughout every stage of these matters.[6]

It was troublesome enough that the Trustee has imposed his cash in/cash out methodology to justify depriving victims of the affirmative relief that SIPA provides they should receive - namely SIPC advances and a share in the Customer Property. What is now being attempted is even more distressing. The Trustee seeks to import that same flawed net equity definition as the means to impose staggering liability on these victims virtually labeling them thieves or the recipients of stolen property. That is a total distortion of the statute.

By disregarding all account statement credits to the account other than deposits and treating all withdrawals over the life of the account as withdrawals of principal, the Trustee has effectively written the applicable statutes of limitation out of the federal and state claims he has asserted. The use of a "cash in/cash out" formulation over the life of an account and related

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[6] Indeed, since the Bankruptcy Code only applies to these actions to the extent not inconsistent with SIPA, at every stage, the interplay between the Bankruptcy Code and SIPA, will require a "significant interpretation" of SIPA to ensure that the particular code provision - and the Trustee's asserted view of it - do not conflict with the language and purpose of SIPA. This is particularly so here given the Trustee's broad and unprecedented expanded interpretation of his powers under both SIPA and the Bankruptcy Code.

accounts (in many cases over the course of decades and multiple generations of investors) would allow the Trustee to reach back and effectively reverse transactions far beyond any applicable statute of limitations. Whether, and why the Trustee believes, SIPA allows him to do so presents yet another substantial issue under SIPA that requires withdrawal of reference to this Court.

It is not insignificant to note that even the SEC takes issue with the Trustee's cash in/cash out methodology unless it is modified to take into account other "fairness factors". The SEC proposes, for example, a "constant dollar" remedy to at least ameliorate some of perceived flaws in the Trustee's methodology. Others have proposed other solutions if the Trustee is allowed to ignore the account statements such as adding an interest component at New York's statutory rate. Still others suggest that SIPA would require an adjustment to reflect taxes that these innocent customers were required to report and pay based solely on Madoff's fraud in his customer tax reports.

It is Defendants' contention that SIPA requires the recognition of their account statements and that none of the suggested adjustments cure this basic defect in the Trustee's cash in/cash out formulation. But if, *arguendo*, adjustments could be deemed curative, the issue of what adjustments would properly accomplish this - if any - clearly presents a separate and significant SIPA issue.

Even if SIPA does not absolutely prohibit avoidance actions against innocent investors who were simply victims of a fraud by a broker-dealer, many of the withdrawals of funds which the Trustee wishes to avoid were mandatory withdrawals of retirement funds, distributions made under ERISA, or used to pay taxes to the IRS and State tax authorities based upon the profits reflected in the account statements and transaction confirmations generated by Madoff that the

Trustee asserts to be fraudulent. As noted, the Securities Act was designed for the protection of investors and SIPA was specifically designed to protect investors, such as the Defendants, who were victimized by frauds committed by a broker-dealer. The Defendants assert that, it is entirely inconsistent with SIPA to allow innocent victims of a fraud to be sued for the recovery of withdrawals that they were required to make in order to comply with other federal laws. Indeed, it is difficult to understand how compliance with tax statutes, for example, which require the withdrawal of funds can logically form the predicate for a claim that such withdrawals should result in clawback liability. These issues and others under these non-bankruptcy federal laws will also require "significant interpretation" both in the context of SIPA protections and standing on their own. These circumstances also require a withdrawal of the reference.

2. The Trustee's Interpretation of SIPA Conflicts with Federal and State Securities Laws as well as the Bankruptcy Code.

All of the withdrawals that the Trustee seeks to reverse through avoidance actions, as well as the previous withdrawals upon which he has based his net "cash in/cash out" calculations, were made in reliance upon account statements and trade confirmations that: (a) the Defendants and their predecessors received and had the right to rely upon as a matter of law; and (b) created obligations owed by BLMIS to the Defendants which were then discharged, at least in part, by the withdrawals that are the subject of the Cases. The Trustee's stated interpretation of SIPA and his claimed authority to bring the instant avoidance actions flies in the face of established federal and state securities law and goes well beyond the avoidance powers granted to him under SIPA and the Bankruptcy Code.

In the complaints in these Cases and in other submissions, the Trustee asserts that

applicable law allows him to treat as nullities all account statements and trade confirmations received by the Defendant customers over the entire course of the customer's account with Madoff. The Trustee thus puts squarely at issue whether an innocent customer may ever rely on any account statements or trade confirmations received from his broker and whether a SIPC trustee can decades later come in and effectively disavow those statements as the Trustee now proposes. Such a proposition, if put into effect, would paralyze the securities industry and infuse it with never-ending uncertainty.

Not surprisingly, federal and state securities law are directly contrary to the claims the Trustee urges. Indeed, under applicable securities laws and regulations, customer account statements and trade confirmations are actually required to be honored as issued to the innocent customer and expressly create obligations from the broker to the customer regardless of whether or not the securities referred to in the documents had actually been purchased by the broker. Those securities laws confirm that a customer may rely on the broker's account statements both to reflect what the customer owns and to show what the broker owes the Customer.

Prior to the enactment of SIPA, stock ownership was generally evidenced by a physical certificate registered in the name of the customer and maintained in the physical custody of the customer. SIPA was enacted, in large part, to address the unwieldy and overwhelming backlog of paperwork that this required. The enactment of SIPA allowed the industry to hold a customer's securities in street name without registering and issuing physical certificates in the customer's name.

As a necessary consequence of that dramatic shift, it was obviously necessary to provide the customer with protections that were serve as the functional equivalent of, or substitution for,

the physical certificate. The account statement and trade confirmation serve that precise function.

These Defendants were customers of a registered broker-dealer subject to SEC regulations and other federal and state securities laws. As such, BLMIS was required to provide account statements and trade confirmations to its customers. *See*, Rule 10b-10, 17 C.F.R. §240.10B-10 (2010); Confirmation of Transactions, 59 Fed. Reg. 59,612, 59,613 (Nov. 17, 1994) (to be codified at 17 C.F.R. pt. 240) ("For over 50 years, the customer confirmation has served basic investor protection functions by conveying information allowing investors to verify the terms of their transactions; alerting investors to potential conflicts of interest with their broker-dealers; acting as a safeguard against fraud; and providing investors the means to evaluate the costs of their transactions and the quality of their broker-dealer's execution.").

FINRA and NYSE rules similarly require the issuance of periodic account statements. *See* NASD Rule 2340 (Customer Account Statements); NYSE Rule 409 (Statements of Accounts to Customers). These statements are deemed so vital to the process that customers who have given their broker trading authority may not waive the right to receive such statements. *See* Confirmation of Transactions, 59 Fed. Reg. 59,612, 59,614 ("The customer may not waive this periodic report.").

The property rights enforced by these federal securities laws and regulations are created under state law. Under Article 8 of the New York Uniform Commercial Code, once an account statement is issued, the broker has incurred an obligation to the customer as reflected therein.

See, NYUCC § 8-501(b) ("a person acquires a security entitlement[7] if a securities intermediary[8]... (1) indicates by book entry that a financial asset has been credited to the person's securities account . . . [or] (3) becomes obligated under other law, regulation, or rule to credit a financial asset to the person's securities account."); NYUCC §8-501 cmt. 2 (It is "a basic operating assumption of the indirect holding system that once a [broker] has acknowledged that it is carrying a position in a financial asset for its customer . . . the [broker] is obligated to treat the customer . . . as entitled to the financial asset.").

Once this obligation is created through the issuance of the statement, the broker owes the securities to the customer whether or not the securities were actually purchased. *See*, NYUCC § 8-501(c) ("a person has a security entitlement even though the securities intermediary does not itself hold the financial asset"); NYUCC § 8-501 cmt. 3 ("The entitlement holder's rights against the securities intermediary do not depend on whether or when the securities intermediary acquired its interests.").[9]

Thus, under applicable federal and state securities laws, BLMIS owed the Defendants and other Madoff customers the securities and amounts set forth in their account statements.

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[7] A "security entitlement" is defined as "the rights and property interest of an entitlement holder with respect to a financial asset [including a security, *see* NYUCC § 8-102(a)(9)(I)] specified in Part 5 [of Article 8]." NYUCC § 8-102(a)(17). It is "a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary." NYUCC § 8-503 cmt. 2.

[8] A "securities intermediary" includes a broker. *See* NYUCC § 8-102(a)(14)(ii).

[9] The Trustee's assertion that BLMIS customers such as the Defendants did not have the right to rely on their account statements and trade confirmations is in direct contradiction to these provisions of federal and state securities law. The resolution of these issues will require substantial interpretation of non-bankruptcy federal law and, therefore, mandates withdrawal of the reference.

According to their account statements and trade confirmations, at the time of each withdrawal, the customer had an account balance at least equal to or in excess of the amount withdrawn. BLMIS owed them the balances reflected in those account statements, as even the Trustee has acknowledged. He says that, although he has denied their SIPC Net Equity claims, each customer is a creditor of BLMIS and entitled, as such, to receive distribution of funds from the estate - albeit, he contends, after the customer claims he has allowed are fully paid.

As a result, it cannot seriously be disputed that the withdrawals which are the subject of the instant actions discharged BLMIS's pre-existing debt to the customers under applicable federal and state securities laws and that, as set forth in their statements, these Defendants were and are creditors of BLMIS. As such, the instant avoidance actions are prohibited. Indeed, those withdrawals cannot be treated as fraudulent conveyances nor form the basis for an avoidance action.

In that regard, it is essential to note that a SIPC trustee's avoidance powers are strictly limited to those provided for under the Bankruptcy Code. 15 U.S.C. § 78fff-2(c)(3) (The Trustee may avoid a transfer but "if and to the extent that [a] transfer is voidable or void under the provisions of title 11."). The Bankruptcy Code does not allow avoidance of transfers made to creditors. *See*, 11 U.S.C. §§ 544, 548. Further, since the account statements reflected that each withdrawal was a repayment of an existing debt, the withdrawal, as a matter of law was *not* a fraudulent conveyance and the Trustee's complaint is defective as a matter of law. *See*, *e.g.*, *In re Sharp Int'l Corp*, 403 F.3d 43, 54 (2nd Cir. 2005) *(* " [A] conveyance which satisfies a antecedent debt made while the debtor is insolvent is neither fraudulent nor otherwise improper, even if its effect is to prefer one creditor over another."); *see also*, N.Y. Debt. & Cred. Law §272

(a transfer which satisfies an antecedent debt is not a fraudulent conveyance since, by statute, the satisfaction of an antecedent debt is deemed "fair consideration" and a "fair equivalent" therefor).

The Trustee's stated interpretation of SIPA is at odds with federal and state securities laws as well as the Bankruptcy Code and, possibly the Internal Revenue Code and ERISA.[10] As stated above, the Trustee's novel interpretation of SIPA alone requires withdrawal of the reference. These conflicts independently require the withdrawal of the reference. *See*, *HSBC*, Bernfeld Declaration, Ex. C, p. 12 (deeming a conflict between SIPA and bankruptcy law as "something that itself warrants withdrawal of the bankruptcy reference"); *see also*, *In re Cablevision*, 315 B.R. 818, 821 (S.D.N.Y. 2004) ("The very existence of a dispute as to whether the rights of [investors] under the [Trust Indenture Act] and Williams Act supersede Section 304 [of the Bankruptcy Code] or whether the Bankruptcy Code overrides the TIA, regardless of the ultimate resolution of such dispute, mandates withdrawal."); *Bear, Sterns Securities Corp. v. Gredd*, 2001 WL 840187, at *2-4 (S.D.N.Y. July 25, 2001) (withdrawing reference where federal securities laws "arguably conflict[ed]" with the Bankruptcy Code).

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[10] As noted above, a number of the transactions that the Trustee seeks to avoid include transfers were mandatory under ERISA or the Internal Revenue Code. How a transfer can be mandatory under the law and yet still subject the recipient to liability as the recipient of a fraudulent transfer is difficult to comprehend . In the same vein, in "regular" accounts, customers were required to report taxable income and pay taxes based on the tax reporting documents prepared and filed by BLMIS. Many of the withdrawals in fact were for the purpose of paying those tax obligations. There is thus a fundamental disconnect between the tax statutes on the one hand (which required customers to report income from Madoff based on Madoff's reports) and the Trustee's asserted interpretation of SIPA and the Bankruptcy Code on the other hand if avoidance actions can be brought based on withdrawals used to pay such taxes.

3. SLUSA.

Unlike the typical avoidance action (whether in the context of a bankruptcy or SIPA liquidation) which simply seeks to avoid individual transfers where the debtor was insolvent at the time and no value was provided in exchange, here, the Cases brought against the Defendants are based upon the Trustee's claim that all monies received as a result of any withdrawal represents "other people's money." *See*, *e.g.*, *Franitza Complaint*, ¶5.

In fact, the Trustee states that he brings this action not on behalf of BLMIS, but rather on behalf of "those defrauded customers of BLMIS who invested more money in BLMIS than they withdrew").[11] By making that claim, the Trustee (perhaps unintentionally) has triggered the need to make an analysis to determine whether these clearly representative claims are "covered class actions" under the Securities Litigation Uniform Standards Act ("SLUSA").

Under SLUSA, a "covered class action" is preempted and required to be dismissed if it, *inter alia*, (a) is based upon state law; and (b) alleges "an untrue statement or omission of material fact in connection with the purchase and sale of a covered security." *See*, 15 U.S.C. §77p; *HSBC*, Bernfeld Declaration, Ex. C, pp. 12-13. A "covered class action" is one in which (1) "damages are sought on behalf of more than 50 or more persons or prospective class members" or (2) "one or more named parties seeks to recover damages on a representative basis on behalf of themselves and other unnamed parties." *See*, 15 U.S.C. §77p(f)(2)(A); *HSBC*, Bernfeld Declaration, Ex. C, p. 13.

Here, the Complaint states that it has been brought on behalf of all of those thousands of customers and alleges untrue statements and omissions of material fact in connection with the

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[11] Each of the Complaints contains an identical allegation.

purchase and sale of covered securities. Each of the actions contains claims under the New York Debtor and Creditor law to recover purportedly fraudulent transfers made to the Defendants as part and parcel of Madoff's fraudulent ponzi scheme.

As a result, it would appear on its face that these claims under the New York Debtor and Creditor Law fall within the preemption provisions of SLUSA and must be dismissed. At a minimum, this Court will be required to interpret SLUSA as it applies to such actions - another matter of first impression raised by these actions- and yet another reason why withdrawal of reference is mandated.[12]

4. Other Withdrawal of Reference Motions

We incorporate by reference any other withdrawal of reference motions made and to be made by other Madoff claw back defendants to the extent relevant to these Cases and if a withdrawal is granted in any of those cases as to any issues not specifically raised herein but which pertain to any of the Cases, we respectfully request that the withdrawal be deemed to apply to these Cases and Defendants as well

[12] This Court has already ruled that interpretation of SLUSA in an analogous context requires withdrawal of the reference. *See*, *HSBC*, Bernfeld Declaration, Ex. C, p. 13-14.

CONCLUSION

For all of the reasons contained herein, the reference to the Bankruptcy Court should be withdrawn.

Dated: New York, New York
June 30, 2011

Bernfeld, DeMatteo & Bewrnfeld, LLP

By:____________/s/____________
David B. Bernfeld (DBB-0177)
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