1 arising in a SIPA proceeding--urges this Court to affirm the
2 order of the bankruptcy court, which holds that on the
3 present facts the Net Investment Method (and not the Last
4 Statement Method) correctly measures "net equity." The
5 objecting BLMIS claimants contend that the Last Statement
6 Method is mandated by the language of SIPA; that they had a
7 legitimate expectation that their customer statements were
8 accurate; that SIPA is designed to protect this legitimate
9 expectation; and that the Net Investment Method undermines
10 the purpose of the statute.

11 First, accepting that the objecting BLMIS claimants are
12 "customers" under SIPA, they are customers with claims for
13 securities. Second, while the objecting BLMIS claimants and
14 the Trustee argue the plain language of SIPA supports their
15 (irreconcilable) positions, we conclude that the statutory
16 language does not prescribe a single means of calculating
17 "net equity" that applies in the myriad circumstances that
18 may arise in a SIPA liquidation.[6] <u>See</u> <u>Sec. & Exch. Comm'n</u>
19 <u>v. Aberdeen Sec. Co.</u>, 480 F.2d 1121, 1123 (3d Cir. 1973)
20 ("The intent of Congress to protect customers of financially

---

[6] The two competing methods of calculating "net equity" proposed by the parties to this litigation are the only two methods at issue here. We do not hold that they are the only possible approaches to calculation of "net equity" under SIPA.

1 distressed security dealers is clear, but the specifics of
2 precise resolution of individual situations are clouded by
3 the provisions of a statute which range far from the clarity
4 of blue sky one might expect in this area of the law.");
5 McKenny v. McGraw (In re Bell & Beckwith), 104 B.R. 842, 848
6 (Bankr. N.D. Ohio 1989) (rejecting "plain meaning" arguments
7 as to meaning of "allocation" under SIPA as "not
8 persuasive"). Differing fact patterns will inevitably call
9 for differing approaches to ascertaining the fairest method
10 for approximating "net equity," as defined by SIPA. See 15
11 U.S.C. § 78fff-2(b)(2).

12 Mr. Picard's selection of the Net Investment Method was
13 more consistent with the statutory definition of "net
14 equity" than any other method advocated by the parties or
15 perceived by this Court. There was therefore no error.[7]
16 SIPA serves dual purposes: to protect investors, and to
17 protect the securities market as a whole. See Sec. Inv.
18 Prot. Corp. v. Barbour, 421 U.S. 412, 415 (1975). Treatment
19 of the BLMIS claimants as customers with claims for
20 securities and calculating "net equity" based on the Net

[7] We express no view on whether the Net Investment Method should be adjusted to account for inflation or interest, an issue on which the bankruptcy court has not yet ruled and which is not before us on this interlocutory appeal.

1 Investment Method effectuates these purposes. As the
2 bankruptcy court observed, "[a]ny dollar paid to reimburse a
3 fictitious profit is a dollar no longer available to pay
4 claims for money actually invested. If the Last Statement
5 Method were adopted," those claimants who have withdrawn
6 funds from their BLMIS accounts that exceed their initial
7 investments "would receive more favorable treatment by
8 profiting from the principal investments of [those claimants
9 who have withdrawn less money than they deposited], yielding
10 an inequitable result." In re Bernard L. Madoff, 424 B.R.
11 at 141. The statutory definition of "net equity" does not
12 require the Trustee to aggravate the injuries caused by
13 Madoff's fraud. Use of the Last Statement Method in this
14 case would have the absurd effect of treating fictitious and
15 arbitrarily assigned paper profits as real and would give
16 legal effect to Madoff's machinations.

17 **I**

18 The threshold issues are whether the BLMIS claimants
19 are "customers" within the meaning of SIPA and, if so,
20 whether they are customers with claims for securities or
21 customers with claims for cash. If the objecting BLMIS
22 claimants are not "customers," 15 U.S.C. § 78lll(2)(A), they
23 are not entitled to the protection of SIPA at all, see Sec.

1 Inv. Prot. Corp. v. Pepperdine Univ. (In re Brentwood Sec.,
2 Inc.), 925 F.2d 325, 327 (9th Cir. 1991). Under SIPA,
3 "[t]he term 'customer' includes . . . any person who has
4 deposited cash with the debtor for the purpose of purchasing
5 securities." 15 U.S.C. § 78lll(2)(B)(i); see also Tew v.
6 Res. Mgmt. (In re ESM Gov't Sec., Inc.), 812 F.2d 1374, 1376
7 (11th Cir. 1987) (observing "that it is the act of
8 entrusting the cash to the debtor for the purpose of
9 effecting securities transactions that triggers the customer
10 status provisions" (emphasis omitted)). It also includes:

11 . . . [a person] who has a claim on account of
12 securities received, acquired, or held by the
13 debtor in the ordinary course of business as a
14 broker or dealer from or for the securities
15 accounts of such person for safekeeping, with a
16 view to sale, to cover consummated sales, pursuant
17 to purchases, as collateral, security, or for
18 purposes of effecting transfer.
19
20 15 U.S.C. § 78lll(2)(A). We conclude that the BLMIS
21 claimants are customers with claims for securities within
22 the meaning of SIPA.

23 While SIPA does not--and cannot--protect an investor
24 against all losses, it "does . . . protect claimants who
25 attempt to invest through their brokerage firm but are
26 defrauded by dishonest brokers." Ahammed v. Sec. Inv. Prot.
27 Corp. (In re Primeline Sec. Corp.), 295 F.3d 1100, 1107
28 (10th Cir. 2002). SIPA provides this protection by ensuring

that claimants who deposited cash with a broker "for the purpose of purchasing securities," 15 U.S.C. § 78lll(2)(B)(i), are treated as customers with claims for securities. This is so because the "critical aspect of the 'customer' definition is the entrustment of cash or securities to the broker-dealer *for the purposes of trading securities*." Appleton v. First Nat'l Bank of Ohio, 62 F.3d 791, 801 (6th Cir. 1995) (emphasis added).

The legislative history supports the view that the BLMIS claimants are customers with claims for securities. "Throughout the [House Report on SIPA,] 'investors' is used synonymously with 'customers,'" and it is clear that an individual who had documentation of his status as a "trading customer . . . was to be protected." Sec. & Exch. Comm'n v. F.O. Baroff Co., 497 F.2d 280, 283 (2d Cir. 1974). Indeed, treating the BLMIS claimants as customers with claims for securities protects their "legitimate expectations" as investors in the securities market. S. Rep. No. 95-763, at 2 (1978), reprinted in 1978 U.S.C.C.A.N. 764, 765. Similarly, SIPA's implementing regulations bolster the shared view of the Trustee, SIPC, and the SEC that a claimant who has "written confirmation" that securities have been purchased or sold on his or her behalf should be

1 treated as a customer with a claim for securities. 17
2 C.F.R. §§ 300.501(b)(1), 300.502(a)(1). The regulation does
3 not, however, mandate that this "written confirmation" form
4 the basis for calculating a customer's "net equity."

5 **II**

6 The BLMIS claimants object that the only way their
7 "legitimate expectations" can be protected is by calculating
8 "net equity" by reference to their last customer statements.
9 We conclude, however, that while the BLMIS customer
10 statements confirm that the BLMIS claimants are properly
11 treated as customers with claims for securities, the last
12 customer statements are not useful for ascertaining "net
13 equity." We "begin[] where all such inquiries must begin:
14 with the language of the statute itself." United States v.
15 Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989). Two
16 provisions interact. SIPA provides that a customer's "net
17 equity" is determined by:

18 (A) calculating the sum which *would have been owed*
19 by the debtor to such customer *if the debtor had*
20 *liquidated*, by sale or purchase on the filing date
21 [of the protective order]--
22
23 (i) *all securities positions* of such customer
24 . . . minus
25
26 (B) any indebtedness of such customer to the
27 debtor on the filing date . . . .
28
29 15 U.S.C. § 78lll(11) (emphasis added). At the same time,

1 SIPA provides that the Trustee should make payments to
2 customers based on "net equity" insofar as the amount owed
3 to the customer is "ascertainable from the *books and records*
4 of the debtor or [is] otherwise established to the
5 *satisfaction of the trustee.*" Id. § 78fff-2(b) (emphasis
6 added).
7 The objecting BLMIS claimants contend that their
8 "securities positions" should be determined by reference to
9 the "liquidat[ion]" value, id. § 78lll(11)(A), of the
10 securities listed on their last customer statements. The
11 Trustee argues that the customer statements do not reflect
12 "securities positions" that could be "liquidated" because
13 the account statements were wholly the invention of Madoff
14 and do not reflect actual securities positions; that any
15 pay-out of "net equity" therefore also requires a review of
16 the "books and records" of BLMIS; and that "the books and
17 records of the debtor reveal that the last statements are a
18 fiction." Br. of Appellee Picard at 28.
19 We agree with Mr. Picard that a SIPA trustee's
20 obligation to reimburse customers based on "net equity" must
21 be considered together with SIPA's requirement that the
22 Trustee discharge "obligations of the debtor to a customer
23 relating to, or net equity claims based upon . . .

1 securities . . . insofar as such obligations are
2 ascertainable from the books and records of the debtor or
3 are otherwise established to the satisfaction of the
4 trustee." 15 U.S.C. § 78fff-2(b)(2); see also Sec. Investor
5 Prot. Corp. v. Lehman Bros. Inc., 433 B.R. 127, 133 (Bankr.
6 S.D.N.Y. 2010) ("Under SIPA, the Trustee is required to
7 determine a 'customer' claim based on the 'net equity' of
8 the customer as shown on the books and records of the
9 debtor." (footnote omitted)). This accords with our usual
10 practice of examining the "overall structure and operation"
11 of a statute. Puello v. Bureau of Citizenship & Immigration
12 Servs., 511 F.3d 324, 329 (2d Cir. 2007). "The meaning of a
13 particular section in a statute can be understood in context
14 with and by reference to the whole statutory scheme, by
15 appreciating how sections relate to one another." Auburn
16 Hous. Auth. v. Martinez, 277 F.3d 138, 144 (2d Cir. 2002).
17 "In other words, the preferred meaning of a statutory
18 provision is one that is consonant with the rest of the
19 statute." Id.
20 When the terms of the statute are read together, the
21 statute directs that a SIPA trustee should determine a
22 customer's entitlement to recover "net equity" based both on
23 the statutory definition of that term and by reference to
24 the books and records of the debtor. While the language of

1 the statute clearly requires a SIPA trustee to distribute
2 customer property based on "net equity," the statute does
3 not define "net equity" by reference to a customer's last
4 account statement. Nor does it say specifically how "net
5 equity" should be calculated if a dishonest broker failed to
6 place a customer's funds into the security market,
7 notwithstanding that the customer "deposited cash with the
8 debtor for the purpose of purchasing securities," id. §
9 78lll(2)(B)(i).

10 Here, the profits recorded over time on the customer
11 statements were after-the-fact constructs that were based on
12 stock movements that had already taken place, were rigged to
13 reflect a steady and upward trajectory in good times and
14 bad, and were arbitrarily and unequally distributed among
15 customers. These facts provide powerful reasons for the
16 Trustee's rejection of the Last Statement Method for
17 calculating "net equity." In addition, if the Trustee had
18 permitted the objecting claimants to recover based on their
19 final account statements, this would have "affect[ed] the
20 limited amount available for distribution from the customer
21 property fund." In re Bernard L. Madoff, 424 B.R. at 133.
22 The inequitable consequence of such a scheme would be that
23 those who had already withdrawn cash deriving from imaginary

1 profits in excess of their initial investment would derive
2 additional benefit at the expense of those customers who had
3 not withdrawn funds before the fraud was exposed. Because
4 of these facts, the Net Investment Method better measures
5 "net equity," as statutorily defined, than does the Last
6 Statement Method.[8] As the bankruptcy court reasoned, "[t]he
7 Net Investment Method is appropriate because it relies
8 solely on unmanipulated withdrawals and deposits and refuses
9 to permit Madoff to arbitrarily decide who wins and who
10 loses." In re Bernard L. Madoff, 424 B.R. at 140.

11 In holding that it was proper for Mr. Picard to reject
12 the Last Statement Method, we expressly do not hold that
13 such a method of calculating "net equity" is inherently
14 impermissible. To the contrary, a customer's last account

[8] Because we find that, in this case, the Net Investment Method advocated by Mr. Picard is superior to the Last Statement Method as a matter of law, we have no need to consider whether a SIPA trustee may exercise discretion in selecting a method to calculate "net equity." Fraud is endlessly resourceful and the unraveling of weaved-up sins may sometimes require the grant of a measure of latitude to a SIPA trustee. It therefore appears to us that that in many circumstances a SIPA trustee may, and should, exercise some discretion in determining what method, or combination of methods, will best measure "net equity." We have no reason to doubt that a reviewing court could and should accord a degree of deference to such an exercise of discretion so long as the method chosen by the trustee allocates "net equity" among the competing claimants in a manner that is not clearly inferior to other methods under consideration.

1 statement will likely be the most appropriate means of
2 calculating "net equity" in more conventional cases. We
3 would expect that resort to the Net Investment Method would
4 be rare because this method wipes out all events of a
5 customer's investment history except for cash deposits and
6 withdrawals. The extraordinary facts of this case make the
7 Net Investment Method appropriate, whereas in many
8 instances, it would not be. The Last Statement Method, for
9 example, may be appropriate when securities were actually
10 purchased by the debtor, but then converted by the debtor.
11 Indeed, the Last Statement Method may be especially
12 appropriate where--unlike with the BLMIS accounts at issue
13 in this appeal--customers authorize or direct purchases of
14 specific stocks. <u>See generally</u> <u>Miller v. DeQuine</u> (<u>In re</u>
15 <u>Stratton Oakmont, Inc.</u>), No. 01-CV-2812 RCC, 01-CV-2313 RCC,
16 2003 WL 22698876 (S.D.N.Y. Nov. 14, 2003).

17 Ascertaining the proper measure of "net equity" in a
18 given case is for the ultimate purpose of issuing payments
19 to customers; so, the ability to deduce payment amounts (to
20 the satisfaction of the trustee) will bear upon the method
21 selected for calculating "net equity." In this case, the
22 Net Investment Method allows the Trustee to make payments
23 based on withdrawals and deposits, which can be confirmed by
24 the debtor's books and records, and results in a

1 distribution of customer property that is proper under SIPA.

2 **III**

3 Under the circumstances of this case, the limitation on
4 the objecting customers' recovery imposed by the Net
5 Investment Method is consistent with the purpose and design
6 of SIPA. "The principal purpose of SIPA is to protect
7 investors against financial losses arising from the
8 insolvency of their brokers." In re New Times Sec. Servs.,
9 Inc., 463 F.3d 125, 127 (2d Cir. 2006) ("New Times II")
10 (internal quotation marks omitted). SIPA is also intended
11 to "protect capital markets by instilling confidence in
12 securities traders." Sec. Investor Prot. Corp. v. Morgan,
13 Kennedy & Co., 533 F.2d 1314, 1317 (2d Cir. 1976). "SIPA's
14 main purpose [i]s . . . not to prevent fraud or conversion,
15 but to reverse los[s]es resulting from brokers' insolvency."
16 In re Stratton Oakmont, 2003 WL 22698876, at *5; see also
17 Appleton, 62 F.3d at 801; In re Brentwood Sec., 925 F.2d at
18 326.

19 The BLMIS claimants characterize the overall statutory
20 scheme as an insurance guarantee of the securities positions
21 set out in their account statements. They maintain that
22 SIPA should operate to make them whole from the losses they
23 incurred as a result of Madoff's dishonesty. We disagree.

1 While this Court has referred to SIPC as providing a "form
2 of public insurance," Packer, Wilbur & Co., 498 F.2d at 985,
3 it is clear that the obligations imposed on an insurance
4 provider under state law do *not* apply to this
5 congressionally-created "nonprofit membership corporation."
6 Barbour, 421 U.S. at 413; see also, e.g., Rosenbluth
7 Trading, Inc. v. United States, 736 F.2d 43, 46 (2d Cir.
8 1984) (observing that although Social Security is often
9 referred to as insurance, "[m]anifestly, social security is
10 not traditional insurance, and consequently principles
11 applicable to [insurance policies] . . . need not be
12 imported uncritically into lawsuits involving social
13 security"). Moreover, a registered broker-dealer may obtain
14 insurance under New York law and, in the event of a SIPA
15 liquidation, New York law governs the relative ability of
16 implicated parties to obtain the benefit of insurance
17 coverage. See generally Am. Bank & Trust Co. v. Davis
18 (Matter of F.O. Baroff Co.), 555 F.2d 38, 41-42 (2d Cir.
19 1977) (stating claimant in SIPA liquidation may share in
20 insurance held by bankrupt debtor).

21 It is not at all clear that SIPA protects against all
22 forms of fraud committed by brokers. See In re Investors
23 Ctr., Inc., 129 B.R. 339, 353 (Bankr. E.D.N.Y. 1991)
24 ("Repeatedly this Court has been forced to tell claimants

1 that the fund created for the protection of customers of
2 honest, but insolvent, brokers gives them no protection when
3 the insolvent broker has been guilty of dishonesty, breach
4 of contract or fraud."); H.R. Rep. No. 91-1613, at 1 (1970),
5 reprinted in 1970 U.S.C.C.A.N. 5254, 5255 (stating "[t]he
6 primary purpose of [SIPA] . . . is to provide protection for
7 investors if the broker-dealer with whom they are doing
8 business encounters financial troubles"). But it is clear
9 that the statute is not designed to insure investors against
10 *all* losses. See, e.g., Packer, Wilbur & Co., 498 F.2d at
11 983 ("SIPA was not designed to provide full protection to
12 all victims of a brokerage collapse."); Sec. Investor Prot.
13 Corp. v. Associated Underwriters, Inc., 423 F. Supp. 168,
14 171 (D. Utah 1975) (SIPA does not "guarantee that customers
15 will recover their investments which may have diminished as
16 a result of, among other things, market fluctuations or
17 broker-dealer fraud"). But, no party has contested the
18 availability of advances under SIPA to cushion the impact of
19 Madoff's fraud.
20 In any event, SIPA is intended to expedite the return
21 of *customer property*, and SIPC provides advances on customer
22 property. Customer property, in turn, is a term defined by
23 the statute as "cash and securities . . . at any time

1 received, acquired, or held by or for the account of a
2 debtor from or for the securities accounts of a customer,
3 and the proceeds of any such property transferred by the
4 debtor, including property unlawfully converted." 15 U.S.C.
5 § 78lll(4). Here, notwithstanding the BLMIS customer
6 statements, there were no securities purchased and there
7 were no proceeds from the money entrusted to Madoff for the
8 purpose of making investments. Moreover, customers share
9 "ratably" in customer property on the basis of their "net
10 equity," id. § 78fff-2(c)(1)(B); so if customers receive
11 SIPC advances based on property that is a fiction, those
12 advances will necessarily diminish the amount of customer
13 property available to other investors, including those who
14 have not recouped even their initial investment. Because
15 the main purpose of determining "net equity" is to achieve a
16 fair allocation of the available resources among the
17 customers, the Trustee properly rejected the Last Statement
18 Method as it would have undermined this objective.

19 **IV**

20 The objecting claimants maintain that a pair of
21 decisions of this Court--New Times I and New Times II--
22 dictate that the Last Statement Method be used to calculate
23 "net equity." We conclude that, to the contrary, our

1 precedent is consistent with the Trustee's decision to
2 utilize the Net Investment Method under the circumstances of
3 this case. And, use of the Last Statement Method in this
4 case would have been an impermissible means of calculating
5 "net equity."

6 Like the BLMIS litigation, the New Times cases arose
7 out of a Ponzi scheme. After the New Times scheme was
8 exposed, a SIPA trustee was appointed and a liquidation
9 proceeding commenced. New Times I, 371 F.3d at 71. The
10 SIPA trustee divided the claimants into two groups. One
11 group of claimants had been misled to believe that they were
12 investing "in mutual funds that in reality existed." Id. at
13 74. "[T]he information that these claimants received on
14 their account statements mirrored what would have happened
15 had the given transaction been executed." Id. (internal
16 quotation marks omitted). The New Times SIPA trustee
17 treated these claimants as customers with claims for
18 securities and reimbursed them based on their account
19 statements. The second group of claimants were
20 "fraudulently induced" to buy "shares in bogus mutual funds"
21 that did not exist. Id. at 71. The New Times trustee
22 treated these claimants as customers with claims for cash;
23 they objected; and the district court sustained their
24 objections, holding that they had claims for securities and

1 that their "net equity" should be determined by reference to
2 their customer statements. Id. The New Times Trustee and
3 SIPC appealed.[9]

4 This Court ruled [i] that the New Times claimants who
5 believed they had invested in mutual funds that did not, in
6 fact, exist, should be treated as customers with claims for
7 securities, but [ii] that their "net equity" could not be
8 calculated by reference to the "fictitious securities
9 positions reflected in the Claimants' account statements."
10 Id. at 75. The New Times I Court was persuaded by the joint
11 view of the SEC and SIPC that "basing customer recoveries on
12 fictitious amounts in the firm's books and records would
13 allow customers to recover arbitrary amounts that
14 necessarily have no relation to reality . . . [and would]
15 leave[] the SIPC fund unacceptably exposed." Id. at 88
16 (internal quotation marks omitted). Calculations based on
17 made-up values of fictional securities would be "unworkable"
18 and would create "potential absurdities." Id. Accordingly,
19 it was held that "each Claimant's net equity should be
20 calculated by reference to the amount of money the Claimants
21 originally invested with the Debtors (*not* including any

[9] The New Times claimants who were originally treated as customers with claims for securities and compensated based on their customer statements were never before this Court.

fictitious interest or dividend reinvestments)." Id. at 71.

In New Times II, this Court concluded that investors in New Times Securities Services who, prior to the SIPA proceeding, "were induced to liquidate their accounts . . . and make a loan of the imaginary funds to the brokerage house and to [the principal]" were not customers within the meaning of SIPA. New Times II, 463 F.3d at 126, 129. They could only legitimately have expected to be treated as lenders unprotected by SIPA. Id. at 130.

Taken together, New Times I and New Times II militate in favor of limiting recovery by BLMIS claimants to their Net Investment. True, the objecting BLMIS claimants are unlike the appellants in New Times I because their customer statements reflected investments in real stocks listed on the Standard & Poor's 100 Index. However, the objecting BLMIS claimants are similarly situated to the New Times appellants in a crucial respect: assessing "net equity" based on their customer statements would require the Trustee to establish each claimant's "net equity" based on a fiction created by the perpetrator of the fraud. Commenting on the New Times I decision, the New Times II Court stated:

> The court declined to base the recovery on the rosy account statements telling customers how well the imaginary securities were doing, because treating the fictitious paper profits as within the ambit of the customers' "legitimate

> expectations" would lead to the absurdity of "duped" investors reaping windfalls as a result of fraudulent promises made on fake securities.

Id. at 130 (quoting New Times I, 371 F.3d at 87-88).

Madoff constructed account statements retrospectively, designating stocks based on advantageous historical price information and arbitrarily distributing profits among his customers.[10] It would therefore have been legal error for the Trustee to "discharge claims upon the false premise that customers' securities positions are what the account statements purport them to be." In re Bernard L. Madoff, 424 B.R. at 135. The Trustee properly declined to calculate "net equity" by reference to impossible transactions. Indeed, if the Trustee had done otherwise, the whim of the defrauder would have controlled the process that is supposed to unwind the fraud.

In any event, SIPA covers potentially a multitude of situations; no one size fits all. See Exch. Nat'l Bank of Chicago v. Wyatt, 517 F.2d 453, 459 n.12 (2d Cir. 1975) (stating SIPA "liquidation procedures have been carefully designed to allow flexibility"). The fact that the trustee appointed to oversee the liquidation underlying the New Times cases calculated "net equity" in one manner is not

[10] Some purported trades were settled outside the Stock Exchange's price range for the trade dates.

1 determinative as to the proper method of ascertaining "net
2 equity" in this case.[11] The New Times trustee calculated
3 "net equity" based on customer statements for those
4 claimants whose account statements "mirrored what would have
5 happened had the given transaction[s] been executed." New
6 Times I, 371 F.3d at 74 (internal quotation marks omitted).
7 Here, however, the BLMIS customer statements reflect
8 impossible transactions and the Trustee is not obligated to
9 step into the shoes of the defrauder or treat the customer
10 statements as reflections of reality.

11 **CONCLUSION**

---

[11] A SIPA liquidation is a hybrid proceeding. See 15 U.S.C. § 78fff-1(a) ("A trustee shall be vested with the same powers and title with respect to the debtor and the property of the debtor, including the same rights to avoid preferences, as a trustee in a case under Title 11."); id. § 78fff(b) ("To the extent consistent with the provisions of this chapter, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under [the Bankruptcy Code]."); see also In re Housecraft Indus. USA, Inc., 310 F.3d 64, 71 (2d Cir. 2002) (stating bankruptcy trustee may avoid fraudulent transactions). As the bankruptcy court ruled, "SIPA and the [Bankruptcy] Code intersect to . . . grant a SIPA trustee the power to avoid fraudulent transfers for the benefit of customers." In re Bernard L. Madoff, 424 B.R. at 136. The objecting BLMIS claimants point out that no avoidance power has been invoked in this case. True, however--in the context of *this* Ponzi scheme--the Net Investment Method is nonetheless more harmonious with provisions of the Bankruptcy Code that allow a trustee to avoid transfers made with the intent to defraud, see 11 U.S.C. § 548(a)(1)(A), and "avoid[s] placing some claims unfairly ahead of others," In re Adler, Coleman Clearing Corp., 263 B.R. 406, 463 (Bankr. S.D.N.Y. 2001).

1 For the reasons set forth above, we affirm the order of
2 the United States Bankruptcy Court for the Southern District
3 of New York (Lifland, J.) and hold that use of the Net
4 Investment Method for calculating the "net equity" of the
5 BLMIS customers was proper.

United States Court of Appeals for the Second Circuit
Thurgood Marshall U.S. Courthouse
40 Foley Square
New York, NY 10007

DENNIS JACOBS
CHIEF JUDGE

CATHERINE O'HAGAN WOLFE
CLERK OF COURT

Date: August 16, 2011
Docket #: 10-2378 bk
Short Title: Securities Investor Protection v. Bernard L. Madoff Investment S

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DC Court: SDNY (NEW YORK CITY)
DC Judge: Lifland

BILL OF COSTS INSTRUCTIONS

The requirements for filing a bill of costs are set forth in FRAP 39. A form for filing a bill of costs is on the Court's website.

The bill of costs must:
* be filed within 14 days after the entry of judgment;
* be verified;
* be served on all adversaries;
* not include charges for postage, delivery, service, overtime and the filers edits;
* identify the number of copies which comprise the printer's unit;
* include the printer's bills, which must state the minimum charge per printer's unit for a page, a cover, foot lines by the line, and an index and table of cases by the page;
* state only the number of necessary copies inserted in enclosed form;
* state actual costs at rates not higher than those generally charged for printing services in New York, New York; excessive charges are subject to reduction;
* be filed via CM/ECF or if counsel is exempted with the original and two copies.

United States Court of Appeals for the Second Circuit
Thurgood Marshall U.S. Courthouse
40 Foley Square
New York, NY 10007

DENNIS JACOBS
CHIEF JUDGE

CATHERINE O'HAGAN WOLFE
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DC Court: SDNY (NEW YORK CITY)DC Docket #: 08-ap-1789
DC Court: SDNY (NEW YORK CITY)
DC Judge: Lifland

VERIFIED ITEMIZED BILL OF COSTS

Counsel for

____

respectfully submits, pursuant to FRAP 39 (c) the within bill of costs and requests the Clerk to prepare an itemized statement of costs taxed against the

____

and in favor of

____

for insertion in the mandate.

Docketing Fee ________________

Costs of printing appendix (necessary copies ____________) ________________

Costs of printing brief (necessary copies ____________ ____) ________________

Costs of printing reply brief (necessary copies ______________) ______________________

(VERIFICATION HERE)

____
Signature

United States Court of Appeals for the Second Circuit
Thurgood Marshall U.S. Courthouse
40 Foley Square
New York, NY 10007

DENNIS JACOBS
CHIEF JUDGE

CATHERINE O'HAGAN WOLFE
CLERK OF COURT

Date: August 16, 2011
Docket #: 10-2378 bk
Short Title: Securities Investor Protection v. Bernard L. Madoff Investment S

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NOTICE OF DECISION

The court has issued a decision in the above-entitled case. It is available on the Court's website http://www.ca2.uscourts.gov.

Judgment was entered on 08/16/2011; and a mandate will later issue in accordance with FRAP 41.

If pursuant to FRAP Rule 39 (c) you are required to file an itemized and verified bill of costs you must do so, with proof of service, within 14 days after entry of judgment. The form, with instructions, is also available on Court's website.

Inquiries regarding this case may be directed to . 212-857-8560

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiff,

-v-

BERNARD L. MADOFF INVESTMENT SECURITIES LLC,

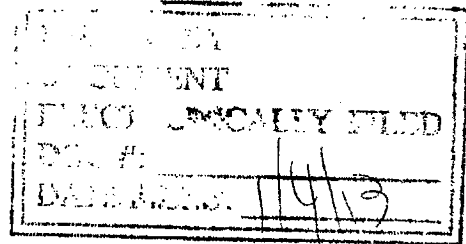
Defendant.

In re:

MADOFF SECURITIES

12 MC 115 (JSR)

OPINION & ORDER



PERTAINS TO CASES LISTED IN EXHIBITS A & C OF ITEM FOUR ON THE DOCKET OF THIS CASE

JED S. RAKOFF, U.S.D.J.

Irving Picard (the "Trustee"), the trustee appointed under the Securities Investor Protection Act ("SIPA"), 15 U.S.C. § 78aaa et seq., to administer the estate of Bernard L. Madoff Investment Securities LLC ("Madoff Securities"), has filed hundreds of actions that seek to avoid transfers made by Madoff Securities on the ground that the transfers were fraudulent or preferential. Defendants in more than three hundred actions have moved based on Stern v. Marshall, 131 S. Ct. 2594 (2011), to withdraw the reference of their cases to the Bankruptcy Court. They argue that the Bankruptcy Court lacks both constitutional and statutory authority to adjudicate the Trustee's claims. On April 13, 2012, the Court consolidated the motions to withdraw that relied on Stern for the purpose of resolving three

issues: (1) whether the Bankruptcy Court may exercise the judicial power necessary to finally decide the Trustee's avoidance actions; (2) whether, even if the Bankruptcy Court may not enter final judgment, it has authority to recommend proposed findings of fact and conclusions of law; and (3) whether the Court, in light of Stern, should withdraw the reference "for cause shown." See Order dated April 13, 2012, No. 12 Misc. 115.

The parties extensively briefed these issues, and the Court heard oral argument on June 18, 2012. While these proceedings occurred, a number of judges in this District, including the undersigned, published opinions that considered the same issues in the context of other bankruptcy proceedings. See, e.g., In re Arbco Capital Mgmt., LLP, 479 B.R. 254 (S.D.N.Y. 2012); Kirschner v. Agoglia, 476 B.R. 75 (S.D.N.Y. 2012); In re Lyondell Chem. Co., 467 B.R. 712 (S.D.N.Y. 2012). These opinions display an emerging consensus. Each concludes that, although the Bankruptcy Court may not ordinarily enter final judgment on avoidance claims, it may nonetheless hear the case in the first instance and recommend proposed findings of fact and conclusions of law. E.g., Arbco, 479 B.R. at 263-67; Kirschner, 476 B.R. at 82-83; Lyondell, 467 B.R. at 724-25. Each case further holds that, because the Bankruptcy Court may issue proposed findings of fact and conclusions of law, the district court need not withdraw "for cause shown" a case referred to the Bankruptcy Court before the Bankruptcy Court has made its report and recommendation. E.g., Arbco, 479 B.R. at 263-68; Kirschner, 476 B.R. at 83; Lyondell, 467 B.R. at 725.

Consistent with that conclusion, the Board of Judges of this District has also amended its standing order of referral of cases to the Bankruptcy Court to provide that "[i]f a bankruptcy judge or a district judge determines that entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution[,] . . . the bankruptcy judge shall . . . submit proposed findings of fact and conclusions of law to the district court." See Amended Standing Order of Reference, No. 12 Misc. 32 (S.D.N.Y. Jan. 31, 2012). Having now fully considered the parties' briefs and arguments, the Court adheres to the District's emerging consensus, adapting it, as described below, to the unique legal and factual considerations presented here.

The Court turns first to the question of whether the Bankruptcy Court may exercise the judicial power necessary to resolve avoidance claims. Article III of the United States Constitution reserves the "judicial Power" of the United States to federal judges who are selected according to specific procedures, "hold their Offices during good Behaviour," and receive compensation in an amount the other branches of the government may not diminish. U.S. Const. art. II, § 2, cl. 2; U.S. Const. art. III, § 1. These requirements protect litigants' rights by ensuring the judiciary's independence. N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 58 (1982). In accordance with Article III, and in furtherance of judicial independence, courts have "have long recognized that, in general, Congress may not 'withdraw from judicial cognizance any matter which,

from its nature, is the subject of a suit at the common law, or in equity, or admiralty.'" Stern v. Marshall, 131 S. Ct. 2594, 2609 (2011) (quoting Murray's Lessee v. Hoboken Land & Improvement Co., 59 U.S. 272, 284 (1856)). Bankruptcy judges neither have life tenure nor are appointed according to the procedures required by Article III. See generally 28 U.S.C. § 152. Thus, whether Congress may empower the Bankruptcy Court to finally resolve a claim, thereby withdrawing that claim from the "cognizance" of an Article III judge, depends on the type of claim at issue.

Specifically, Congress may empower administrative agencies or legislative courts (so called "Article I" courts) -- including the Bankruptcy Court -- to resolve matters involving public rights, but not matters involving private rights. N. Pipeline, 458 U.S. at 69-70. Public rights relate to the "performance of the constitutional functions of the executive or legislative departments," N. Pipeline, 458 U.S. at 68 (quoting Crowell v. Benson, 285 U.S. 22, 50 (1932)), and are "closely integrated into a public regulatory scheme." Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 54 (1989) (quoting Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568, 594 (1985)). Congress can commit such matters entirely to the executive's discretion, and thus it also has the lesser power of providing for their resolution by an Article I court. See N. Pipeline, 458 U.S. at 68 ("The understanding of these cases is that the Framers expected that Congress would be free to commit such matters completely to nonjudicial executive determination, and that as a result there can be

no constitutional objection to Congress' employing the less drastic expedient of committing their determination to a legislative court or an administrative agency."). In contrast, Congress cannot empower Article I courts to finally adjudicate matters "of private right, that is, of the liability of one individual to another under the law as defined." Stern, 131 S. Ct. at 2612 (quoting Crowell, 285 U.S. at 50-51).

In Granfinanciera, the Supreme Court, considering whether a defendant had a Seventh Amendment right to a jury trial, held that a Trustee's right to recover a fraudulent transfer is "more accurately characterized as a private rather than a public right" because suits to avoid transfers "are quintessentially suits at common law that more nearly resemble state-law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res." 492 U.S. at 55-56.[1] In Stern, the Court applied the same analysis to the determination of whether Congress could empower a non-Article III tribunal to finally decide a claim. 131 S. Ct. at 2614.

[1] Although Granfinanciera considered whether a defendant in an avoidance action had a Seventh Amendment right to a jury trial, the Supreme Court analyzed that question under the framework it had previously developed for determining whether a non-Article III tribunal could finally decide a claim. See 492 U.S. at 49 ("Unless Congress may and has permissibly withdrawn jurisdiction over that action by courts of law and assigned it exclusively to non-Article III tribunals sitting without juries, the Seventh Amendment guarantees petitioners a jury trial upon request."). Because the same framework applies to both issues, the Court cannot distinguish Granfinanciera on the ground that it did not consider whether the Bankruptcy Court may finally decide avoidance actions. Moreover, the fact that, as described below, Stern relied on Granfinanciera when considering whether the Bankruptcy Court could finally decide certain claims further demonstrates that the same framework applies to both issues.

Specifically, the Court held that the state-law counterclaim at issue, "like the fraudulent conveyance claim at issue in Granfinanciera[, did] not fall within any of the varied formulations of the public rights exception in this Court's cases." Id. Thus, the Court concluded that Congress had improperly vested judicial power in a non-Article III judge when it allowed bankruptcy courts "to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim." Id. at 2620. It reached this conclusion even though the counterclaim was a "core" bankruptcy proceeding. Id. at 2604.[2]

It is true, as the Court in Stern noted, that in certain circumstances, the Supreme Court has permitted bankruptcy courts to finally resolve avoidance actions. In Katchen v. Landy, the Supreme Court held that, when a creditor had filed a claim to the bankruptcy estate, and the bankruptcy trustee had sought both to disallow that claim and to avoid a preference, the Bankruptcy Court could decide the

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[2] The Trustee notes that the Supreme Court characterized its holding as a "narrow" one that would not "meaningfully change[] the division of labor" between bankruptcy and district courts. Stern, 131 S. Ct. at 2620. But such dictum cannot trump the Court's holding that the state-law counterclaim at issue, "like the fraudulent conveyance claim at issue in Granfinanciera[, did] not fall within any of the varied formulations of the public rights exception in this Court's cases." Id. at 2614 (emphasis added). Where the Supreme Court's dicta arguably conflicts with the logic of its holding, lower courts are bound to follow its logic. Kirschner, 476 B.R. at 81 ("[C]autionary dicta and past practice do not overcome the logic of the Supreme Court's holding in Stern.") Other courts in this District have reached the same conclusion. See Arbco, 479 B.R. at 264 ("[T]he Trustee's argument ignores Stern's conclusion that the bankruptcy court can enter final judgment only on those claims that fall within the public rights exception . . . ."); Lyondell, 467 B.R. at 721 ("This argument runs directly contrary to the clear language of Stern.").

avoidance action. 382 U.S. 323, 336-38 (1966). In so doing, the Court first noted that the Bankruptcy Court had jurisdiction over whether to disallow the creditor's claim to the estate. Id. at 336. It also observed that, under the statute that then governed the disallowance of claims, "a bankruptcy court must necessarily determine the amount of preference, if any, so as to ascertain whether the claimant, should he return the preference, has satisfied the condition imposed by [the statute] on allowance of the claim." Id. at 334. Because the Bankruptcy Court had jurisdiction to decide issues that would completely resolve the trustee's preference claim, the Supreme Court reasoned that the Bankruptcy Court necessarily also had the power to decide that preference claim. Id. at 336-37.[3] Langenkamp v. Culp, decided after Granfinanciera, reached an identical result. See 498 U.S. 42, 44 (1990) ("[T]he creditor's claim and the ensuing preference action by the trustee become integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's equity jurisdiction."). In Stern, however, the Court distinguished Katchen and Langenkamp on the ground that the Bankruptcy Court did not need to

[3] Nonetheless, the Supreme Court "intimate[d] no opinion concerning whether the referee has summary jurisdiction to adjudicate a demand by the trustee for affirmative relief, all of the substantial factual and legal bases for which have not been disposed of in passing on objections to the claim." Katchen, 382 U.S. at 332 n.9. In Stern, the Supreme Court distinguished the claim at issue on the ground that there was "never reason to believe that the process of ruling on Pierce's proof of claim would necessarily result in the resolution of Vickie's counterclaim," suggesting that a disallowance claim must totally subsume an avoidance action for a Bankruptcy Court to have authority to issue a final decision in that action under Katchen. 131 S. Ct. at 2617-18.

resolve the debtor's counterclaim for defamation in order to decide the creditor's claim to the estate. 131 S. Ct. at 2616-17.

Here, the Trustee brings his avoidance actions under SIPA, rather than the Bankruptcy Code. See 15 U.S.C. § 78fff-2(c)(3) ("[T]he trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of Title 11."). The Court has no difficulty concluding that avoidance actions under SIPA, like those under the Bankruptcy Code, assert private rights. See Granfinanciera, 492 U.S. at 56 ("There can be little doubt that fraudulent conveyance actions by bankruptcy trustees . . . are quintessentially suits at common law."). This conclusion applies equally to actions that seek to avoid transfers as fraudulent and actions that seek to avoid transfers as preferential. See Schoenthal v. Irving Trust Co., 287 U.S. 92, 94 (1932) ("In England, long prior to the enactment of our first Judiciary Act, common-law actions of trover and money had and received were resorted to for the recovery of preferential payments by bankrupts."). Since the Supreme Court looks at the historical nature of a claim to determine whether it asserts a private or a public right, it would appear that whether an avoidance action arises under the Bankruptcy Code or under SIPA matters little. As in Stern, an avoidance action -- whether brought under SIPA or under the Bankruptcy Code -- "is not a matter that can be pursued only by grace of the other branches, . . . or one that historically could have been determined exclusively by those

branches." 131 S. Ct. at 2614 (citations and internal quotation marks omitted). Resolution of an avoidance action brought under SIPA would thus require an exercise of the judicial power reserved for Article III courts.

In an effort to avoid this conclusion, the Trustee, joined by the Securities Investor Protection Corporation ("SIPC"), argues that avoidance actions brought under SIPA assert public rather than private rights. The Trustee argues that Congress, by referring claims to an agency with "obvious expertise" at administering the relevant statutes and regulations, can bring claims within the public rights exception in order to make "effective a specific and limited federal regulatory scheme". CFTC v. Schor, 478 U.S. 833, 855-56 (1986). According to the Trustee, his claims here, unlike avoidance actions under the Bankruptcy Code, "derive[] from a federal regulatory scheme," namely, SIPA. Noting that a liquidation proceeding under SIPA differs from one under the Bankruptcy Code -- for example, SIPA prioritizes "customers" over other creditors and provides that they "share ratably . . . to the extent of their respective net equities," 15 U.S.C. § 78fff-2(c)(1)(B) -- the Trustee and SIPC argue that, because avoidance actions permit the Trustee to recover funds in order to pay priority claims, see 15 U.S.C. § 78fff-2(c)(3), these actions form an integral part of SIPA's statutory scheme, and thus assert a public right.

Although the Supreme Court concededly has not always given an "entirely consistent" definition of the public right exception, making its contours "the subject of some debate," avoidance actions lack

several of the characteristics shared by claims that assert public rights. Stern, 131 S. Ct. at 2611. In Stern, the Supreme Court defined the public rights exception to include only "cases in which the claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert government agency is deemed essential to a limited regulatory objective within the agency's authority." Id. at 2613. Not every statutory scheme qualifies as "a federal regulatory scheme." If Congress could transform a private right into a public right merely by incorporating that right into a statutory scheme, then Article III would offer litigants little protection. See id. at 2615. Instead, whenever the Supreme Court has held that "a federal regulatory scheme" creates a public right, a regulatory agency has administered that scheme. See, e.g., Schor, 478 U.S. at 855-56; Thomas v. Union Carbide Agric. Prod. Co., 473 U.S. 568, 590 (1985). In Schor, the relevant agency possessed an "obvious expertise" that facilitated decision-making, and the agency's assertion of jurisdiction over a seemingly private right was "necessary to make the [larger scheme] workable." 478 U.S. at 855-56. Similarly, in Thomas, Congress could have authorized the relevant agency to make the decision in question, and thus it had the lesser power of referring that decision to arbitrators. 473 U.S. at 589-90. Finally, in both cases, the adjudicative scheme was partly consensual. Schor, 478 U.S. at 855; Thomas, 473 U.S. at 589.

Here, Congress has referred avoidance actions under SIPA not to a regulatory agency, but instead to the Bankruptcy Court. While the

Bankruptcy Court has relevant expertise, the Trustee and SIPC do not contend -- nor could they -- that Congress could empower an executive agency to decide avoidance actions without recourse to adjudicative proceedings. Moreover, the Trustee and SIPC have not explained why permitting the Bankruptcy Court to finally decide avoidance actions under SIPA is "necessary to make" SIPA's statutory scheme "workable." Although avoidance actions may serve different purposes under SIPA than they do under the Bankruptcy Code, the fact that proceedings under the Bankruptcy Code do not empower the Bankruptcy Court to finally decide avoidance actions strongly suggests that proceedings under SIPA do not do so either. See 15 U.S.C. § 78fff(b) ("[A] liquidation proceeding shall be conducted in accordance with, and as though it were be conducted under . . . Title 11."). Finally, many parties to avoidance actions under SIPA, including the defendants here, do not consent to adjudication of their cases by the Bankruptcy Court. Thus, "[w]hat is plain here is that this case involves the most prototypical exercise of judicial power: the entry of a final, binding judgment by a court with broad substantive jurisdiction, . . . when the action neither derives from nor depends upon any agency regulatory regime." Stern, 131 S. Ct. at 2615.

Even though the Trustee's avoidance actions assert a private rather than a public right, the Bankruptcy Court may nonetheless have the authority to finally resolve those actions to the extent that, under Katchen, it must decide a claim that raises the same issues as the avoidance action. Under Katchen, where the Bankruptcy Court has

independent authority to decide whether to disallow a defendant's claim to the estate, and a decision on that issue would bind the parties under normal principles of res judicata in a separate avoidance action, the Bankruptcy Court may resolve the avoidance action to the extent necessary to effectuate its independent authority. 382 U.S. at 334-35; see also Stern 131 S. Ct. at 2617 ("[T]here was never any reason to believe that the process of adjudicating Pierce's proof of claim would necessarily resolve Vickie's counterclaim."). This approach prevents the existence of identical issues from eroding the Bankruptcy Court's jurisdiction over claims that Congress has appropriately empowered it to resolve. Moreover, it avoids the risk of inconsistent decisions that exists whenever two different courts must resolve identical issues.

Because SIPA governs the liquidation of Madoff Securities' estate, different types of claims are implicated than in an ordinary liquidation under Title 11. In a SIPA proceeding, customers of the debtor can file claims to recover their "net equit[ies]," i.e., "the sum which would have been owed by the debtor to such customer if the debtor had liquidated, . . . on the filing date[,] . . . all securities positions of such customer." 15 U.S.C. §§ 78fff-2(b), 78lll(11). Determining the amounts of customers' net equity claims does not require the Bankruptcy Court to conclusively resolve any of the issues that arise in an avoidance action, much less the action in its entirety. See generally 11 U.S.C. §§ 547, 548. In this liquidation proceeding, the Bankruptcy Court has rejected many customer claims

simply because the customer, according to the Trustee's calculations, had no net equity. The Second Circuit has affirmed the Bankruptcy Court's decision and approved the Trustee's method for determining net equity claims. See generally In re Bernard L. Madoff Inv. Sec. LLC, 654 F.2d 229 (2d Cir. 2011). Nonetheless, these decisions have not resolved important issues that avoidance actions raise, and thus they have not bound the parties as res judicata. Accordingly, the fact that certain defendants have filed net equity claims, standing alone, does not empower the Bankruptcy Court to finally decide the Trustee's avoidance actions. As in Stern, the Court has no "reason to believe that the process of adjudicating" net equity claims "would necessarily resolve" the Trustee's avoidance actions. 131 S. Ct. at 2617.[4]

It may be noted in passing that in only one circumstance could the Bankruptcy Court conceivably resolve an avoidance action in the process of deciding a claim over which it has jurisdiction. Under 11 U.S.C. § 502(d), the Bankruptcy Court "shall disallow any claim of any entity . . . that is a transferee of a transfer avoidable under section . . . 547 [or] 548 . . . of this title, unless such entity has paid the amount . . . for which such entity or transferee is liable." Evidently, where the Trustee has sought to disallow a claim under § 502(d), the Bankruptcy Court will have to determine whether the claimant has received "a transfer avoidable under section . . . 547 [or] 548." Indeed, Katchen involved the statutory predecessor of

[4] This conclusion applies with equal force to subsequent transferees whose claims to Madoff Securities' estate have been rejected because the subsequent transferees fail to qualify as "customers" of Madoff Securities.

§ 502(d), which forbade the allowance of a claim when the creditor had "received or acquired preferences . . . void or voidable under this title." 382 U.S. at 330. Thus, under Katchen, whenever the Bankruptcy Court must resolve a § 502(d) claim brought by the Trustee, it may also finally decide avoidance actions to the extent that those actions raise the same issues as the § 502(d) claim and thus would "necessarily" be resolved by it.

The defendants argue that, even if the Bankruptcy Court has the authority to decide avoidance actions in the process of resolving claims under § 502(d), it still cannot resolve any of the avoidance actions under consideration because § 502(d) does not apply in SIPA proceedings. The defendants rely principally on Picard v. Katz, which dismissed a § 502(d) claim on the ground that it conflicted with 15 U.S.C. § 78fff-2(c)(3), see 462 B.R. 447, 456 (S.D.N.Y. 2011), and on In re Ames Dep't Stores, Inc., which held that § 502(d) does not apply to claims for administrative expenses under § 503(b) of the Bankruptcy Code, see 582 F.3d 422, 432 (2d Cir. 2009). However, the Court need not determine in this Opinion whether SIPA alters the normal application of § 502(d) because it has received separate consolidated briefing on that issue in all of the adversarial proceedings in this liquidation that have identified the issue as a basis for withdrawal of the reference. See Order dated June 1, 2012, No. 12 Misc. 115. If, after consideration of that more extensive briefing, the Court concludes that § 502(d) does not apply in SIPA proceedings, the

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See In re Aozora Bank Ltd., 480 B.R. 117, 120 (S.D.N.Y. 2012).

Bankruptcy Court will have no occasion to decide avoidance actions in the process of resolving claims under § 502(d).

Having concluded that the Bankruptcy Court may not finally decide avoidance actions except conceivably in the process of resolving identical claims under § 502(d), the Court must now consider whether the Bankruptcy Court may nonetheless hear the case in the first instance and recommend proposed findings of fact and conclusions of law, which the district court would then review de novo. "The jurisdiction of the bankruptcy courts, like that of other federal courts, is grounded in, and limited by, statute." Celotex Corp. v. Edwards, 514 U.S. 300, 307 (1995). "Section 157 [of Title 28] classifies matters as either 'core proceedings,' which the bankruptcy court may 'hear and determine' and on which the court 'may enter appropriate orders and judgments,' § 157(b)(1), or 'non-core proceedings,' which the bankruptcy court may hear, but for which the bankruptcy court is only empowered to submit proposed findings of fact and conclusions of law to the district court for de novo review, § 157(c)(1)." In re Orion Pictures Corp., 4 F.3d 1095, 1100-01 (2d Cir. 1993). "Core proceedings include" actions to avoid or recover both "preferences" and "fraudulent conveyances." 28 U.S.C. § 157(b)(2)(F) & (H). The classification of avoidance actions as core raises the following issue: as a result of the subsequent decision in Stern, it is now clear that Article III prohibits the Bankruptcy Court from exercising in many instances the power that § 157 explicitly confers. Thus, the Court must therefore determine whether the Bankruptcy Court

may "submit proposed findings of fact and conclusions of law" with respect to avoidance actions even though § 157 does not explicitly empower it to do so.

Where a constitutional infirmity disrupts the operation of a statutory scheme, courts must "seek to determine what Congress would have intended in light of the Court's constitutional holding." Nat'l Fed. of Bus. v. Sebelius, 132 S. Ct. 2566, 2607 (2012) (quoting United States v. Booker, 543 U.S. 220, 246 (2005)). Nonetheless, courts are not "free to rewrite the statutory scheme in order to approximate what we think Congress might have wanted had it known that [a particular provision] was beyond its authority." Seminole Tribe of Fla. v. Florida, 517 U.S. 44, 76 (1996). Here, the Court need not attempt to "approximate" Congress's intent because, as numerous courts have previously noted, the history and structure of § 157 indicate that Congress "clearly 'wanted Bankruptcy Judges to finally adjudicate bankruptcy-related matters whenever Article III permitted them to do so, and to issue recommended findings subject to de novo review in the District Court whenever it did not.'" Kirschner, 476 B.R. at 82 (quoting In re Coudert Bros. LLP, 2011 WL 5593147, at *13 (S.D.N.Y. Sept. 23, 2011)). Neither does the Court rewrite the statutory scheme by permitting the Bankruptcy Court to recommend proposed findings of fact and conclusions of law. Congress attempted to empower the Bankruptcy Court to "hear and determine" avoidance actions. This grant of broad power necessarily conferred on bankruptcy courts the lesser power of issuing proposed findings of fact and conclusions of law. Cf.

United States v. Crosby, 397 F.3d 103, 117 (2d Cir. 2005), abrogated in part on other grounds by United States v. Fagans, 406 F.3d 138, 142 (2d Cir. 2005). While the Constitution prohibits Congress from giving the Bankruptcy Court the broad power it intended, that prohibition does not extend to the lesser, included power that Congress also conferred.[5] Accordingly, the Court determines that, had Congress known that it could not empower bankruptcy courts to "hear and determine" avoidance actions, it would have wanted those courts to exercise the lesser power it implicitly conferred on them to propose findings of fact and conclusions of law.[6]

The defendants argue that Stern rejected the interpretation of § 157 that the Court now claims is clear. Of course, because the Bankruptcy Court had already entered final judgment in Stern, 131 S. Ct. at 2601, the Supreme Court had no occasion to consider whether the

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[5] The larger statutory scheme supports this conclusion. Under 28 U.S.C. § 1334, the district courts have original jurisdiction over cases arising under Title 11. Section 157 of Title 28 permits the district courts to refer "any or all cases" under Title 11 to the Bankruptcy Court. Because the district courts need not refer any cases to the Bankruptcy Court, it follows that they may refer even core cases to the Bankruptcy Court while reserving the power to enter final judgment.

[6] As this Court has previously noted, even if Congress had not clearly intended this outcome, the District likely could unilaterally empower the Bankruptcy Court to issue proposed findings of fact and conclusions of law. Kirschner, 476 B.R. at 82. If the Constitution completely invalidated the relevant provisions of § 157, no statute would explicitly govern the issue under consideration. Under Fed. R. Bankr. P. 8018(b), whenever "there is no controlling law," district courts may "regulate practice in any manner consistent with federal law." Thus, district courts have more latitude to prescribe procedures in this context than they do in others. Indeed, when questions last arose concerning the Bankruptcy Court's jurisdiction, this District adopted a rule that permitted bankruptcy courts to issue proposed findings of fact and conclusions of law, and the Second Circuit upheld that rule. In re Kaiser, 722 F.2d 1574, 1580 (2d Cir. 1983). As noted above, this District has recently issued a similar order. See Amended Standing Order of

Bankruptcy Court could have issued proposed findings of fact and conclusions of law. Instead, the Supreme Court considered the defendant's argument that it need not decide whether § 157 conflicted with Article III because § 157 did not permit the Bankruptcy Court to finally determine the claim at issue. The defendant based that argument on the proposition that § 157, rather than identifying all "counterclaims by the estate" as core proceedings, see 28 U.S.C. § 157(b)(2)(C), instead designated as core only those counterclaims that arise in a Title 11 case or arise under Title 11. 131 S. Ct. at 2604. The Supreme Court rejected that proposition, concluding that the detailed provisions of § 157 foreclose any interpretation that would create a large class of claims for which "the statute provides no guidance." Id. at 2605. In other words, the Supreme Court concluded that Congress had classified all counterclaims as core proceedings.

This conclusion in Stern in no way conflicts with this Court's holding that Bankruptcy Courts are still free to issue proposed findings of fact and conclusions of law with respect to the initial avoidance actions. The Court has accepted that Congress categorized all avoidance actions as "core" proceedings, asking instead what Congress would have intended had it known that it could not empower the Bankruptcy Court to finally decide such actions. This approach comports with the Supreme Court's prior cases. See Sebelius, 132 S. Ct. at 2607 (concluding that Congress had unconstitutionally attempted to "penalize States . . . by taking away their existing Medicaid

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Reference, Case No. 12 Misc. 32 (S.D.N.Y. Jan. 31, 2012).

funding," but then asking "what Congress would have intended in light of the Court's constitutional holding" (quoting Booker, 543 U.S at 246)); see also Booker, 543 U.S. at 245-46. Simply put, the conclusion that Congress unavoidably exceeded its powers under the Constitution does not relieve the Court of its obligation to consider what Congress would have intended had it known of the relevant constitutional limitations. Moreover, as noted above, the Court's interpretation of § 157 does not "rewrite" the statute. Unlike the defendant's interpretation of § 157 in Stern, the Court's interpretation does not create a large class of cases for which "the statute provides no guidance," but instead only recognizes Congress's intent to empower the Bankruptcy Court to issue proposed findings of fact and conclusions of law with respect to an avoidance action whenever it cannot enter final judgment.

Having determined that the Bankruptcy Court may issue proposed findings of fact and conclusions of law, the Court turns finally to the question of whether, in light of Stern, it should withdraw the reference "for cause shown" before the Bankruptcy Court has issued its report and recommendations.[7] Prior to Stern, courts determining whether to withdraw for cause considered several factors: "(1) whether the claim is core or non-core, (2) what is the most efficient use of judicial resources, (3) what is the delay and what are the costs to the parties, (4) what will promote uniformity of bankruptcy

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[7] Certain of the issues here consolidated seek withdrawal on other grounds, and nothing in this Opinion should be taken as ruling on those independent grounds for withdrawal, which will be dealt with separately in accordance

administration, (5) what will prevent forum shopping, and (6) other related factors." In re Burger Boys, Inc., 94 F.3d 755, 762 (2d Cir. 1996). Following Stern, a number of courts applying this test have concluded that, because the classification of a claim as core or non-core no longer definitively determines whether the Bankruptcy Court may enter final judgment, courts should instead look "at whether, under Stern, the Bankruptcy Court has the final power to adjudicate [the claim at issue]." Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP, 462 B.R. 457, 467 (S.D.N.Y. 2011).

Multiple courts in this District have already concluded that, although Stern prevents the Bankruptcy Court from entering final judgment on avoidance claims, considerations of efficiency and uniformity counsel in favor of permitting the Bankruptcy Court to issue proposed findings of fact and conclusions of law. Arbco, 479 B.R. at 267-68; Kirschner, 476 B.R. at 83; Lyondell, 467 B.R. at 725. Indeed, prior to Stern, courts in this District did not withdraw the reference for cause at the outset of proceedings merely because the claim at issue was "non-core." See In re Kenai Corp., 136 B.R. 59, 61-62 (S.D.N.Y. 1992). The Court follows the approach adopted in Arbco, Kirschner, and Lyondell. As the Court noted in Kirschner, "experience strongly suggests that having the benefit of the report and recommendation will save the district court and the parties an immense amount of time." 476 B.R. at 83.

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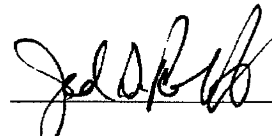
with prior orders of this Court.

The defendants make two arguments in favor of withdrawal at this stage of proceedings. First, they argue that declining to withdraw the reference may require the Court to conduct duplicative proceedings. Cf. Cullen v. United States, 194 F.3d 401, 407 (2d Cir. 1999). The hypothetical possibility of duplicative proceedings, however, cannot outweigh the efficiency of receiving the recommendation of a court that possesses both intimate familiarity with the underlying liquidation and substantial expertise in the bankruptcy law that applies to these avoidance actions. Second, the defendants argue that, because the Court has previously withdrawn the reference in these and similar cases to resolve many issues that require substantial and material consideration of non-bankruptcy law, withdrawal of these cases in their entireties will promote uniform interpretation of the relevant non-bankruptcy law. What this argument ignores, however, is that this Court may resolve the issues of non-bankruptcy law and then remand for further proceedings in the Bankruptcy Court, thereby obtaining the benefits of its expertise. Indeed, the Court has adopted a method of proceeding that allows it to resolve individual issues of non-bankruptcy law once for all of the cases that present them. See, e.g., Order dated April 19, 2012, No. 12 Misc. 115. Once the Court has uniformly resolved issues of non-bankruptcy law, the Bankruptcy Court should have the opportunity to apply its expertise to the complicated project of uniformly administering Madoff Securities' estate.[8]

[8] The defendants also argue that, if a higher court ultimately determines that the Bankruptcy Court lacks power to issue proposed findings of fact and conclusions of law, then it may vacate any decision that adopts one of the

In sum, the Court follows other courts in this District, as well as its own prior precedent, in concluding that, although Stern precludes the Bankruptcy Court from finally deciding avoidance actions (unless, possibly, the Trustee has sought to disallow a claim to the estate under § 502(d)), the Bankruptcy Court nonetheless has the power to hear the matter in the first instance and recommend proposed findings of fact and conclusions of law. The Court further declines to withdraw the reference of these cases to the Bankruptcy Court "for cause shown" before the Bankruptcy Court has issued appropriate findings of fact and conclusions of law. Except to the extent provided in other orders, the Court directs that what remains of the adversary proceedings listed in Exhibits A and C of item number four on the docket of 12 Misc. 115 be returned to the Bankruptcy Court for further proceedings consistent with this Opinion and Order.

SO ORDERED.



JED S. RAKOFF, U.S.D.J.

Dated: New York, New York
January 4, 2013

Bankruptcy Court's reports and recommendations. Such an outcome would hypothetically require relitigation of each case in its entirety. Higher courts, however, seem exceedingly unlikely to adopt the approach the defendants fear. Because the district courts unquestionably have jurisdiction over these cases, higher courts likely will not vacate their decisions merely because they adopt conclusions that, having conducted de novo review, they necessarily reached after independent consideration.